FINANCING AMERICAN INDUSTRY

AND OTHER ADDRESSES

E. H. H. SIMMONS
President, New York Stock Exchange

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E. H. H. SIMMONS

President, New York Stock Exchange

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This is the second volume of the collected speeches of E. H. H. Simmons, President of the New York Stock Exchange, and contains the speeches delivered by Mr. Simmons between May 1927—*May* 1930.

The first volume, "Modern Capitalism, and other addresses," contains the speeches delivered by Mr. Simmons between May 1924—*May* 1927.

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FINANCING AMERICAN INDUSTRY

Address before the Engineers' Society of Western Pennsylvania, at Pittsburgh, Pa., January 30, 1928

Such an intimate relationship has long existed between the great industrial center of Pittsburgh and the leading American financial center of New York, that New York financial men must always feel thoroughly at home here. It is almost unnecessary to state that I appreciate the honor and privilege of being invited to this meeting, and of having this opportunity to speak to you on a few phases of Stock Exchange activity which are not without their interest and significance to your own business operations. This is all the more pleasant an undertaking because the community of interest between Pittsburgh manufacturers and New York bankers and security dealers has in the past made possible such constructive progress in both industry and finance. If I were arbitrarily to select the one outstanding industry of our country which has been signally aided by the banking and stock market facilities, I would probably select your great steel industry. And so tonight I wish particularly to discuss certain financial aspects of the extraordinary development which the American steel industry has experienced in the last quarter century.

II

For the past hundred years and probably even longer, credit has been a recognized facility in almost all lines of business enterprise. Nevertheless, the organization of credit facilities in our banks and our stock exchanges has of necessity been subject to certain limitations arising from the very character of American finance. In its earliest stages, industry benefits least by our modern credit facilities. The inventor must begin his work in most cases without

the assistance of regular credit facilities. Thus it has been that so many of the great industrial inventions, which have to such an extent revolutionized the world in which we live, have been originally created in obscure and humble work-shops. More and more as industry progresses the great need of systematically financing research and invention is being appreciated, and many of our most progressive industrial concerns, of course, are now undertaking this work on a scale and with an intensity unequalled anywhere in the world. Nevertheless, industrial inventions during their inception will probably continue to benefit little by the ordinary credit machinery of this country.

But with practical and useful inventions the period is always reached when expansion becomes necessary, and when the experimental stage of development gives way to the further stage of systematic production. In rare cases the inventor may be such an able executive, or the invention may prove so unusually successful, that this stage of expansion can be financed directly out of the earnings of the enterprise itself, and without recourse to borrowing at the banks or financing through security dealers. This was, for example, the experience which Mr. Ford had with his first extraordinarily profitable low-priced car, which is now apparently doomed after years of usefulness to find its place in our industrial museums. In the average case, however, the immediate earnings of a new industry are not sufficient in this way to finance its continued growth and expansion, and it is at this point that the use of credit becomes necessary. To some extent local bankers and local capitalists can and do finance such rising industrial concerns. But the power of our ordinary commercial banks to engage in this work is naturally limited by the necessity under which the banker works, to keep his portfolio liquid in order to be able to pay off the demand deposits which are

so largely the source of his available funds. Thus, with a continually growing industry, it is almost inevitable that a stage will ultimately be reached where the public must be taken into partnership through the public disposal of company debts and equities in the form of the company's bonds and shares. It has been entirely typical of the growth of American industry during the past half century that while its working capital might to a large extent be obtained from short-term banking discounts and advances, its permanent capital has had to be sought in the American stock markets. In consequence, the real problem of our rising industries has been one involving long, rather than short-term, credit.

III

It is unnecessary for me to cite specific instances of these general principles in the case of the steel industry. You are of course even more familiar with them than I am. But I only wish to point out that it was not until the steel industry had developed large units that it became the prominent consideration in our New York securities markets that it has been for the last thirty years. In the work of selling steel securities to the American investment public, however, the original New York bankers encountered much the same problem which had earlier attended the same individuals with railroad and other securities. In the beginning steel securities were new and as the phrase goes, "unseasoned." The investor who buys securities to hold permanently is almost always timid, and very naturally hesitates to place his funds in securities which have not behind them a certain tradition in the financial markets. The result was, with steel as with practically all other American securities, that the bulk of their new share issues had to be sold to speculators who did not intend to hold them permanently, but who considered that they were sufficiently attractive to permit re-sale within

a reasonable time at higher prices. It is, after all, owing to the assistance of this large and growing body of security speculators, as distinguished from security investors, that new companies can be so readily financed in this country, and that new industries can so easily obtain the large sums needed for growth and expansion.

It is a fashionable but, I feel, a fallacious attitude to take, that security speculators are a great and regrettable economic nuisance. Sometimes critics have suggested to me that the Stock Exchange would be a vastly better institution if only speculative operations could somehow be eliminated from it. With this conclusion I cannot agree. Without the assistance of the speculative security buyer the vast work which has been accomplished in the past century of building up this nation's transportation and productive industries could never have been accomplished, and this is a somewhat late date to wring our hands and bewail the existence of a process of financial speculation which has been so constantly and so greatly responsible for the entire up-building of our country. Without the speculator, either industry could not be financed as readily and as inexpensively as it is today, or else the investor in this country would be forced to assume risks which he has every reason and every instinct to avoid. To cite the willingness of Americans to speculate and trade in securities is only to call attention in financial terms to the fact that we are an imaginative and progressive people, untrammeled by mere tradition and always willing to undertake reasonable risks for reasonable prospective benefits and betterments.

As I have already stated, the steel industry itself provides perhaps the classical example of the truth of these assertions. Many of you will of course recall the terrific competition in the steel industry prior to the beginning of the 20th century. In good years enormous profits and great expansion would

regularly occur, while bad years would witness cut-throat competition and painful collapses and insolvencies. The industry was attended by constant uncertainty. It almost wholly lacked stability, despite its vast importance to the entire business community. Thus it came about that not only additional funds were made available to the steel industry, but also an equally valuable quality of stability, when in 1901 the house of Morgan created and financed the United States Steel Corporation. This achievement measured by its subsequent results to the nation's industry and trade has proved one of the crowning triumphs of that great banking firm. The creation of the Steel Corporation largely brought order out of chaos, and assured a steadier and more certain prosperity in what has proved perhaps the chief of our basic industries.

Although the Steel Corporation is no longer a new company, certain phases of its original financing are still of importance and significance to us, since even yet they are not wholly completed. This is my excuse for examining the exact financial methods whereby United States Steel securities were first created and issued in some detail. It must be remembered that the Steel Corporation's bankers, J. P. Morgan & Company, like all true houses of issue, was primarily a merchant in securities. Instead of undertaking to buy and hold itself all of the new issues of United States Steel, what it of course actually did was to merchandise these securities to the American investing public. Since American security investors very naturally prefer to have a regular market in which their investments can be speedily and safely sold, United States Steel bonds and stocks were promptly listed on the New York Stock Exchange as the standard organized securities market in this country. In this way, American investors were given assurance of their ability to buy and sell these issues under rigorous regulations de-

signed to protect them in these dealings. Thus the New York Stock Exchange became a vital factor in the task of distributing United States Steel securities among the investors of this and other countries.

IV

I have already pointed out the difficulties which almost always attend the sale of new security issues involving any important degree of risk to permanent investors. Many might be inclined to think that once the United States Steel Corporation had been organized, and its securities underwritten, sold to the public, and listed on the New York Stock Exchange, the process was completed. Indeed, from the immediate standpoint of the Steel Corporation itself, this was largely the case, since it had obtained the funds which it required and was able to prosecute its own business without further anxiety on this score. But Steel shares had not and could not be immediately sold to investors. Speculative security buyers had been actually depended upon to take considerable portions of both common and preferred issues. Before even the greater portion of these new Steel securities could be permanently lodged with actual investors, a long and gradual process was required which is frequently lost sight of outside of the financial center. I refer to the gradual acquisition of speculatively held securities by investors, as these issues become seasoned and more suitable for purely investment holding.

This process is with most companies a somewhat mysterious and difficult one upon which to obtain exact information. But one of the fortunate aspects of using the United States Steel Corporation as my principal example here tonight, lies in its unusually comprehensive accounts and statistics. The United States Steel Corporation is entitled to great credit for its foresightedness in seeing the need of taking

the American public into its confidence, and for conscientiously striving to do this by the frequent presentation of adequate accounts. The Steel Corporation, in fact, has provided a striking leadership in the movement in this country toward wider and franker corporate publicity which has gained such headway in recent years, and which is so profoundly responsible for imparting stability to American finance as well as American industry and trade.

One feature of the United States Steel accounts is practically unique, and too little attention has been given it by our economists. I refer to the statistics which the Steel Corporation issues each quarter, as to the percentage of its shares which stand in the names of brokerage firms and the percentage standing in private names. For the most part, of course, the Steel shares which stand in individual names represent securities which have been purchased outright as investments by individuals in this and other countries, whereas the Steel shares standing in brokerage or banking names represent for the most part the shares which are still held by speculative dealers in the market "floating supply" and have not as yet been so distributed to permanent investors. I do not claim that these statistics in every case measure the extent of the floating supply with mathematical accuracy. But they are sufficiently accurate to enable us over a long period of years to observe the economic process whereby speculatively held securities are gradually absorbed by investors, and in consequence to realize the highly important distributive functions of the New York Stock Exchange, and of the security collateral loans contracted by its members to carry this undistributed floating supply of securities.

Referring to these figures, then, at the end of 1909 about two-thirds of the common stock of the Steel Corporation was registered in brokers' names, and about one-third in the names of individuals, showing

that even eight years after the formation of the Steel Corporation about two-thirds of its common stock had not yet been purchased by permanent investors. But with the continued success of the Steel Corporation, and the diminishing risk which attended the ownership of its shares, these proportions changed. By October 1, 1913, about half of the common stock of the Steel Corporation was held by investors and half in the speculative floating supply. By April 1, 1920, two-thirds of United States Steel common was held by investors and one-third by speculators. At the end of 1920 the speculative holdings of Steel common had declined still further to only 25% of the total issue, and at still later dates the figures indicate that over 80% of the issue was held by investors. In this way the assistance of liquid stock markets such as is maintained on the New York Stock Exchange, permits security issues to be gradually withdrawn from the speculative floating supply and lodged in the strong boxes of investors as these issues become seasoned in the market and more obviously attractive to permanent security-holders. Thus it is that the Stock Exchange, although appearing only in the later stages of corporate financing, and performing its invaluable functions gradually and sometimes obscurely, is so vital a factor in facilitating the flow of American capital into large-scale American industry. And in this slow process, it is well not to under-estimate the actual economic services of the speculative security dealer, without whose willingness to assume large risks, the entire economic fabric of this country never could have been built up with such amazing efficiency and speed.

V

In describing this important distributary work accomplished through the facilities of the Stock

Exchange, whereby investment capital is so steadily enabled to find its way into large-scale American industry, I have centered the discussion on the specific case of the United States Steel Corporation, partly because of the adequate statistics which exist in this respect for its particular stocks, and particularly also because of the natural interest in them in Pittsburgh—the historical center of the American steel trade. I should, however, go on to point out that the New York Stock Exchange has performed precisely similar functions for all the other industries whose securities have been from time to time admitted to trading on its floor. Ever since 1792, when the first New York brokers formed the first free and open securities market there, this work has steadily gone on. Originally banks and insurance companies found there not only buyers of their shares for investment, but also that support from more speculative buyers without which their original organization and subsequent growth would have been rendered difficult if not impossible of accomplishment. Since about 1840, the services of the stock market were extended to American railroad companies, and if since that time we have so completely spanned this vast continent with steel highways for efficient commerce and transportation, no small credit in this vast task must be assigned to the capital market in New York, which has so greatly facilitated the steady flow of capital into this basic industry. When subsequently beginnings were made in the large-scale exploitation of our petroleum and mineral wealth, or in the organization of utility companies and manufacturing enterprises of all sorts, the capital market on the New York Stock Exchange continually served as a means of raising capital for them. Today even a glance at the list of New York Stock Exchange securities will reveal the great variety of business enterprises which have called on the market for capital, and not in vain. As new

industries arise in our midst, almost inevitably they come to be represented on the New York Stock Exchange. In recent years, the scope of the market has expanded even beyond the bounds of the United States, and a considerable variety and amount of foreign securities of all kinds on our list today now symbolize the growing international significance of the New York securities market.

Through the facilities of the New York Stock Exchange, the investors of the United States are enabled at a very low commission cost to place their surplus funds in a variety of securities which literally cover a range from China to Peru. Instant publicity is through our ticker system given to the prices for each and all of these securities, as they are made in the open market. Furthermore the initial precautions taken by the Exchange before securities are admitted to it, obtain for the investor much information concerning the governments or the business enterprises in which he is about to invest which otherwise would be unobtainable. The New York Stock Exchange has gone further than any similar organization in the world, in its so-called "listing requirements," in behalf of the investing public of this country. It is of course true that the Stock Exchange does not, and should not attempt to, offer specific investment advice to investors as to what securities they should purchase, nor do its listing requirements constitute *per se* any guarantee by the Exchange as to the investment qualities of its listed issues. But, on the other hand, very real protection of many different kinds is by virtue of our listing requirements afforded to American security buyers, and it is the aim of the Exchange to develop further whenever possible this species of public-spirited service.

Owing to the high organization and efficient administration of the New York financial markets, there has been created in this country a steady and

highly important though often disregarded flow of capital in regular and safe-guarded channels throughout the area of the continental United States. It is no doubt unfortunate that this flow of capital cannot be more clearly visualized. With the steel industry, for example, the successive steps which lead from the iron and coal mines to the deliveries of finished steel products at our doors, is a romantic and a graphic story. Anyone with a particle of imagination can, in his mind's eye, follow the iron ore from the mine to the plants where it is smelted into pig iron, and the further progress of this pig iron to the steel furnaces where steel ingots are produced, and then the further movement of steel ingots to the fabricating steel plants where it is manufactured into bars, plates and shapes of all descriptions. This story of steel has called forth the powers of our descriptive novelists, and of our artists and engravers. It possesses a pictorial quality which cannot fail to interest and impress even the least imaginative person. I wish that capital could somehow be rendered as easily visualized as pig iron or steel, and that the flow of capital through the New York financial markets could be similarly set forth in novels, paintings and etchings so that the average person might readily understand it. Unfortunately, however, capital is not a thing tangible and definite like steel. Even the nature of capital still provides a subject of controversy for the economists, and its transfer from place to place and from person to person is largely invisible except on the ledgers of banks and brokerage offices. Nevertheless the daily flow of stock and bond certificates in and out of Wall Street, and through the various parts of Wall Street, and the steady issuance of money checks in and to all parts of the country, is an economic phenomenon of major importance in our daily lives, and becomes increasingly so each year. Upon the powerful and yet always delicate and sensitive

mechanism of our financial markets, the business prosperity of the nation is immediately and continually dependent.

VI

Since the Armistice, and particularly during the past few years, events in the business and financial world have moved with astonishing rapidity. We have all been somewhat bewildered by our very prosperity, by the tremendous expansion of our productive facilities, and by the revelation of our enormous national resources of capital. It is, therefore, perhaps inevitable that there is present in this country a feeling of doubt concerning the permanence of our prosperity and of our present abundance of wealth and capital. I may be accused, in referring to this situation, of philosophizing about a process that is not yet completed and not yet analyzed. I realize that even our profoundest economic thinkers usually explain economic processes only as these have reached almost their full flower. And yet I cannot help but raise a dissenting voice to the statements which we are hearing today that we are simply living in a fool's Paradise, that a saturation point in industry and finance has been reached, and that having passed its peak, prosperity in this country must necessarily recede and diminish in the future. I am somewhat impatient with the foreign philosophers who recently have been imported into this country at no slight expense in order to inform us that we are on the point of dissolution and decay, and that only the dark outlook of China or India yawns before us. Such views seem preposterous to me. America today stands in control of an only partially exploited continent, with for the first time in her history, adequate capital and scientific control over her economic processes. To these dark prophecies as to our national future, scientists continu-

ally give the lie by remarkable discoveries and inventions which they are producing in the laboratories of the nation. Anyone who is ready to predict the end of the scientific age can scarcely be numbered even among the intelligent readers of our daily newspapers.

The wants and desires of human beings are limitless, and the opportunities for capital and industry to supply these wants and desires are equally without limit. Today the higher standard of living in this country is in itself responsible for greater demands of all sorts upon all our industries. With the continual cheapening of production costs, the continual improvement of manufacturing and distributing processes, there is no reason why this trend to still higher standards of living and still greater prosperity should terminate now. Indeed, many of the mechanical difficulties which used to stand in the way of long-sustained prosperity in the United States have in recent years been triumphantly overcome. Perhaps the most striking example of this sort is in our Federal Reserve banking system. Formerly this country possessed one of the worst banking systems in the world—a system whose deficiencies in themselves were largely responsible for the violent ups and downs of the so-called American "business cycle." In finance as well as in industry, we have substituted exact information and scientific control for the guesswork and rule-of-thumb methods which formerly ruled both our financial and industrial enterprises. In the New York Stock Exchange itself, the mechanism for marketing the capital securities of the nation has similarly been greatly strengthened and improved in efficiency and safety. These steady processes of improvement attract usually little attention, and yet they are vital factors in the maintenance of prosperity in America. Pessimistic prophets are usually innocent of any knowledge of these matters whatever, nor do they

enter into consideration when gloomy prophecies concerning our national future are made.

With all the bewilderment natural to a period of rapid change, with all the confusion naturally attendant upon the ever-mounting figures which reveal our national well-being, American industrial prosperity, and the financial facilities which play so large a part in it, are more firmly founded today than ever before in our history. We are by constant effort and scientific methods creating a new type of civilization in this country whose benefits are broadly distributed to the entire population of the United States. The end is by no means in sight, but there is not yet present in our industrial or financial situation elements which should make us doubtful of the universal benefits and higher cultural opportunities for everyone which, under our very eyes, are being shaped today by the steady effort of our brains and our hands.

SECURITY FRAUDS

A NATIONAL BUSINESS LIABILITY

Address before the Annual Meeting of the Better Business Bureau Managers, at New York City, September 20, 1927

25898

SECURITY FRAUDS

A NATIONAL BUSINESS LIABILITY

It seems somewhat needless to remark that I am pleased indeed to have this opportunity of addressing The Better Business Commission and representatives of the Better Business Bureaus of the nation on the subject of security swindling and the methods which we may, working in concert, succeed in devising and utilizing to stop this serious evil.

One fundamental difficulty in the attempts which have been made by the government and private business organizations alike to curtail the activities of the sellers of fraudulent stocks and bonds arises from the fact that swindling is such an ancient and deep-rooted occupation. Before the world possessed any recorded history, I have no doubt that both swindlers and their victims existed, and that even in those far distant periods it proved to society in general a most difficult problem to inhibit the one and protect the other. The earliest literature of the world abounds in instances of swindling, and the attempts of fair-minded men of all periods to abolish it. It was from the ancient forum of Rome—originally the principal market place of that city—that the grim old law of "let the buyer beware," originated.

Wide as the field has always been for the sale of fraudulent goods, and fraudulent methods in selling even legitimate goods, it is highly doubtful if the opportunity to swindle was ever so constantly presented as in our own times, and particularly with securities. Stocks and bonds have undoubtedly proved the most convenient vehicle for fraud which the development of society has ever afforded, owing to the subtleties and complexities which one must encounter in endeavoring really to ascertain their actual value. It is consequently true that unless the present all-pervasive tendency to organize human enterprise into

corporations with securities which are offered for sale to the public, is matched step by step with a wider education of the public in investment methods, and with superior methods for detecting and punishing swindlers, the fraud problem in American business and financing alike will prove one of constantly increasing danger, not only to the victims of fraud themselves, but also to the entire public.

I do not wish to suggest that the endeavors in this country to prevent swindling in securities have not been as earnestly and hopefully undertaken as in the other leading countries of the world. There is no modern nation whose citizens accumulate surplus funds through thrift, and whose government and industries depend upon security financing, which escapes scot-free from this swindling evil. As far as the desire of American law-makers and American business men to check fraud is concerned, this country has at any rate the distinction of possessing more numerous and more complicated laws on the subject than probably any other nation in the world. Despite this sincere effort in the past to curtail the swindler within our own gates which is so distinctly revealed by our voluminous laws on the subject, our experience seems to indicate that in this volume of law lies a danger rather than a help in actually abolishing the evil. Moreover, the United States has proved a particularly lucrative field for security swindlers because of our vast internal distances, the remoteness of many of our towns from our financial centers, and most of all through the very prosperity which this whole country has for so many years enjoyed.

A final particular difficulty with the fraud problem in the United States arises from the very character of our own people. As we all know, vision and hopefulness are closely allied to credulity. The restless, ambitious and changeable character of the American people, always seeking self-improvement, always inquiring into some new thing, makes us particularly

susceptible to the wiles of the skillful security swindler, who not only holds out glittering promises of unusual profits, but closely follows the shifts in public opinion in the latest enthusiasm in regard to new enterprises. No sooner do the legitimate business markets reveal a need for oil and an unusually profitable prospect for legitimate oil companies, than the salesman of fraudulent oil stocks begins his nefarious operations. When we experience a local or national real estate boom, the swindler is promptly on the spot ready to sell the public rotten mortgages and deceptively useless land improvement schemes. When the profits of the stock broker increase, the ever-versatile security swindler changes his role and sets up a bucket-shop. The pursuit of fraud thus must continue from one form of swindling to another, as one legitimate industry after another is menaced by its inroads upon public enthusiasm and private investment funds. In consequence the undertaking to limit and check fraud requires not only an extreme persistence and enthusiasm, but enough imagination and versatility of mind to follow the evil into the latest business field into which it has extended. Above all a constant vigilance is required if practical results in the work are actually to be obtained.

II

The problem of fraud and swindling is too large to be included in any neat little formula. One may approach the question from the legal, the moral or the economic standpoint. Inasmuch as I am neither a lawyer nor a clergyman I cannot pretend here, except in a very general way, to go into the legal and moral aspects of the question. But I do feel that it is useful to grasp just how much of a business and economic problem the swindling evil really is, and on this particular aspect of the matter I would call your attention to certain things. It is a capital mistake

to think that the harm done in the sale of fraudulent securities and in other forms of swindling stops with the victim. Actually the evil affects everyone and in an inescapable manner. If the effects of security frauds were confined simply to dispossessing individuals who could afford such losses, the practice would of course be indefensible, but it becomes intolerable when, as really is the case, these burdens and losses caused by fraud fall upon parties unable to endure them.

It is well to recognize that the investing public of this country is no longer confined to any single locality in the nation, or to any particular social class. During the past twenty years a remarkable transformation in the whole security business has been occasioned by the tremendous broadening of our investing public. Even a casual examination of the stock holders list of practically any of our great business corporations will show to what an astonishing extent corporate shares have been distributed to the rank and file throughout this entire country. The same thing is also true in the case of bonds. It has been the testimony of bond houses and bond dealers for many years that to an increasing extent bonds are being sold in this country in small units and to a very large number of small investors, rather than to a small class of wealthy ones. It is this very breadth and diversity in our investing public today which makes intolerable the continuance of security swindling, as far as the victims of the practice themselves are concerned. Twenty years ago it might be said that people with enough money to invest in securities should know what they were doing, and needed as a class no particular protection against fraud. But today no such statement can be made, and the small investor needs and deserves all the assistance in this respect which can be lent to him by governmental authorities or business cooperation.

I have said that the loss of their savings by in-

dividuals who cannot afford such loss is a particularly intolerable feature of the fraudulent security problem. This aspect of the question is of course well-known. In any country there is a large class of economically helpless individuals who are dependent for their living upon invested funds. Security investment is the economic basis upon which not only widows and orphans but invalids likewise are compelled to depend. In the light of the cruel and intense hardships which losses through fraud entail upon this class of the economically helpless, there should be little sympathy and admiration in this country for the alleged cleverness and dexterity with which some of our get-rich-quick Wallingfords perhaps operate. The public aspect of the sufferings which this economic class must endure through security frauds lies not only in a decreased ability to purchase and consume, but frequently upon future aid in the form of hospitals and pauper institutions. The day when a helpless individual was permitted by the State to die in the streets has fortunately long passed. But it must always be remembered that the factors which cause poverty compel for that very reason a burden of taxation upon the entire public. When the records of the inmates in some of our charitable institutions are examined, this statement will not be found either exaggerated or fanciful. Only too often has it happened that the financial harm wrought by the stock swindler has ultimately to be assumed by the State.

But it is not simply the economically helpless that suffer, and suffer seriously from the sale of fraudulent securities. As a class, the independent farmers are likewise seriously menaced whenever a wave of security frauds sweeps the country. I have been informed recently, that in a great agricultural state of the West the financial difficulties caused by a certain crop failure there in the last few years could have been avoided almost entirely had the farmers

avoided investing their surplus funds in spurious securities. The cities must give serious consideration to all these economic problems of our modern day as they bear upon the farmers and the agricultural worker, for as we know upon the well-being of agriculture practically all permanent prosperity of this country depends. After all, farming must be looked upon like any other business. The farmer in his operations needs a cash surplus to work with precisely as any industry does, in order that he may be in a position to extend his operations at the right times and in order to secure himself against lean and unprofitable years. As far as the farmer actually does accumulate such surplus funds—and in the long run it does not make so very much difference whether he invests these funds himself or by proxy through local financial institutions, he must face and struggle with the same problem as everyone else faces in similar circumstances. It is, of course, the particular misfortune of the farmer that he is apt to live far from the larger centers of population where the facilities for safe investing can be more readily placed at his disposal. For this very reason the sale of fraudulent securities to the farmer seems to me a particularly important matter at the present time, and I have no doubt that most country bankers would agree with me in this opinion.

Another class whose interests are vitally affected by the continuance of security frauds are the skilled workmen of the country. In recent years there has been a remarkable beginning made from the new practice of distributing the shares of large corporations among the employees, and generally speaking this practice has been hailed as the solution of many acute problems and a hopeful sign for the future. But it must also be recognized that as far as employees are persuaded and encouraged to invest in industrial shares, and indeed encouraged in the habit by the obvious benefits of such investment in good con-

cerns, they may become more rather than less susceptible to the blandishments of the salesman of fraudulent securities. Fortunately for American labor, its outstanding organizations are taking a keen and far-sighted attitude toward the financial welfare of the employed class. Recently, as we are all aware, organized labor has even entered the banking field and indeed the security business, and this development should, I feel, be welcomed very heartily by American financial men as affording very valuable possibilities in protecting labor from unwise and unsound financial investments. It is to be hoped that the new labor banks and similar financial institutions organized by and for American labor will give particular attention to the problem of security swindling as it relates to the workers of the nation, and do their utmost to protect them against the swindler's inroads. For, as far as labor is concerned, the fraudulent stock salesman works a double harm. Not only does he deprive the workman of surplus funds, but through the general economic effect of this fraud he is a powerful deterrent to the stability of employment which is basic to a prosperous laboring class.

Finally there is the class of manufacturers and merchants who suffer from security swindling not only through their own personal losses, but by competition with fly-by-night concerns whose fundamental purpose is to manufacture and sell securities rather than those products which they sometimes so extensively advertise. Moreover, capital which might be given to legitimate manufacturing and mercantile distribution is very often diverted by the fraudulent stock promoter into unsound and thoroughly undesirable ventures of all kinds. This misdirection of capital which the swindler purposely and intentionally effects, is of course a burden on all legitimate business.

There is consequently no social or economic class in our country without its own peculiar grievances

against security swindling, and its own reasons for desiring to see this national economic menace curtailed and abated.

III

No one can study the problem of fraud in modern America without being deeply impressed with its universal effects and its national significance. Purely on a nation-wide claim the evils which it produces must for this reason also be considered.

Perhaps the most obvious economic effect of security frauds is the powerful discouragement which they lend to saving and thrift. One does not have to be a professional economist to be aware of the fact that the capital which one possesses today represents simply the savings of yesterday, and that our whole capitalistic system could not continue if everyone consumed all that they produced. As a matter of practical psychology thrift is always least practiced at the start, and the man who saves a certain amount out of his annual income for permanent income needs particularly to be encouraged during the first few years when such savings are apt to seem so inconsiderable in amount. Unless one is born thrifty the practice of saving is after all an artifical habit which must be carefully and persistently acquired. But if the small investor's savings are suddenly wiped away by the security swindler, it is difficult to persuade him of the actual usefulness of continuing to save and invest. Indeed the operations of the security swindler as they affect the small saver and investor are apt to resemble the decline of the German mark, when even the thriftiest Germans became finally persuaded that it was foolish to do anything but to spend whatever money they had as rapidly as possible. Naturally, any such idea as this strikes at the very heart of our whole national prosperity. We are, I think, all quite persuaded of the great potentialities for good which small-scale investment possesses. But if this

desirable movement is to continue, and to grow in force and scope, the continual threat of security swindlers must be rapidly curtailed.

A further general and undesirable effect which follows from the sale of worthless securities is the interference which it affords to the smooth and easy flow of capital into productive enterprise. American prosperity is indeed largely founded on the wholesale and inexpensive production of goods, which in turn depends on the wholesale facilities for production which security investment alone can assure. Every dollar that is diverted from this indispensable task by the security swindler is a dollar lost to the productivity and to the prosperity of the nation. In proportion as the sellers of fraudulent stocks and bonds succeed, the task of placing legitimate securities is made more difficult and more costly. In so far as the crooked stock salesman persuades the public that security purchasing is a dangerous and risky matter, to that extent will the buyer insist, except in the case of absolutely gilt-edged securities, on greater returns for his capital to compensate him for this actual or imaginary element of risk. As business men, I do not need to point out to you the importance in our national standard of living of the costs of capital. No branch of production or consumption in the country can wholly omit interest charges on money as one of its necessary expenses. If the swindling evil could be abated such costs might be reduced, to the benefit of everyone in the land.

Finally there is also a public aspect of the swindling evil which should be considered. Fraud strikes a foul blow at all credit, which is the most sensitive commodity in the world. The victims of fraud are human. In only exceptional cases do they thoroughly understand the technicalities of legitimate security investing and the machinery for its furtherance which has been gradually built up in this country. When

they realize that they have been swindled they become possessed with the very human and instinctive desire to strike back. The trouble comes that they do not always consider with perfect knowledge or accuracy just upon whom they should attempt to wreck vengeance for their wrongs. The swindler who has fleeced them has usually departed, and cannot be found. The result is that the victim of fraud strikes at legitimate finance and legitimate government. Naturally the only result of this very human and yet thoroughly deplorable tendency is to weaken whatever safeguards for the investor actually are in existence. This is a very old experience in Wall Street, and I dare say every financial center in the country has not been without experiences of the same order. The financial firms and institutions which do an honest business, and which by that fact continue in existence year after year, are left to bear the brunt of unjustified abuse which the rapidly appearing and disappearing vendor of crooked securities so continually leaves in his wake. Much the same thing can be said in regard to our Federal and State governments, which, in the same way, are frequently attacked and assailed by the swindlers' victims, despite the fact that every effort may have been made by governmental authorities to prevent swindling in all its forms. By such a process a deep and persistent suspicion and mistrust against not only legitimate business but even against our free and democratic government is constantly being instilled within public opinion as a direct effect of security swindling. If for no other reason, security swindling is obviously a national problem, and in its solution requires a national effort to curb it.

IV

Fundamentally the cure for the fraudulent securities problem consists in a thoroughgoing educa-

tion of the investment public. We are justified in feeling gratified at the extent to which progress in this direction has been made in recent years. There has been a very general spread of knowledge as to investments throughout this country, and the American public is awakening to the practical as well as the purely theoretical aspects of the subject. Many banks and other financial houses are assisting in this necessary educational work by issuing special studies on various financial topics in such form as to attract and interest the public. The press is likewise performing a most salutory public function in spreading a knowledge of investment matters broadcast through the land. The schools and colleges are likewise turning their attention to more elaborate and technical instruction in investment matters, realizing how significantly this knowledge and technique bears on the happiness and prosperity of the average man. Nevertheless the present situation in regard to fraudulent security selling cannot be met wholly by educational methods, since these are after all so very slow. In spite of the educational work which has been done, the investing public hesitates to avail itself of the services and facilities for avoiding loss through fraud which already exist, for all that it is so ready to criticize our government and our financial institutions after swindling has occurred. The educational effort to protect the public against fraud must be continued with all the persistence, ingenuity and vision that can possibly be mobilized for the task. Yet in addition there must be serious effort also for the more practical results obtainable through an efficient enforcement of the law.

One encouraging sign in respect to the legal aspect of the fraud problem is the greater and greater tendency to punish swindlers unsparingly and severely. Indeed a parallel movement is developing throughout almost all American criminal law enforcement. Recently New York State has found that more severe

punitive laws are showing a most salutory effect in curbing the criminal. The tendency, in respect to almost all criminal abuses, is to enforce vigorously the laws which we already have, rather than to engage in the search for some new and more complicated form of anti-criminal legislation.

But law enforcement in connection with the fraudulent securities problem has been found a highly complicated matter, owing to the multiplicity of American laws which throughout our various states are applicable to swindling, and the many separate parties, both governmental and private, which have organized to abate the evil. It has been in this particular phase of anti-fraud work that the Better Business Bureau organizations have done such a varied service, and have proved such a great practical aid in the task. Through the Better Business Bureau organizations the victim of security swindling can bring his case to the attention of all the fraud-fighting agencies in the country, and all the public and private influences which they can command may through these organizations be mobilized to search out and punish the swindler. The Better Business Bureaus thus serve on a national scale in the fight against fraud which so many different interests and parties have undertaken. To an important extent they have succeeded in unifying the efforts of these hitherto individual fraud-fighting bodies all over the country.

The remarkable service which the Better Business Bureaus have rendered against the swindler can only be realized when present conditions are contrasted with those which obtained previous to the organization of these bureaus. One of the greatest difficulties under which governmental officials endeavoring to fight fraud formerly worked, was the infrequency with which actual cases of fraud were called to their attention. Even with the best of intentions, and with practical laws in their service governmental officials did not make the greatest possible headway

unless instances where fraud had been committed were brought regularly and specifically to their attention. As we all know, the Better Business Bureaus have succeeded most brilliantly in performing just this work. They have enabled the prosecuting arms of our Federal and State governments to obtain a speedy and effective contact with the concrete cases of swindling which they are attempting to prosecute and punish. The result has been in one district after another where these Better Business Bureaus have been organized, that the security swindler has suddenly found his occupation becoming a most hazardous and uncertain one. Speaking as the President of the New York Stock Exchange I am frankly very gratified that this national service rendered by the Better Business Bureaus, which has been so materially supported by the New York Stock Exchange from the time when the work was strenuously undertaken, has proved such an undoubted service to the American investing public. I can only urge that all further cooperation which financial and commercial firms and institutions can afford be regularly extended to the Better Business Bureau organizations in their useful and indispensable efforts to suppress fraud.

In the effort which the American government and American business are today making to drive the security swindler out of existence, a work is being performed in the economic and business field closely resembling that which medical men perform in the field of public health and sanitation. The medical profession is to be congratulated in the extent to which it has educated the public in matters of health and specific measures rendering it immune to the scourges of disease which formerly worked such havoc with human life. As we all know there are economic diseases and economic parasites which call for a similar concerted effort by all the forces of legitimate business in this country. We must go constantly forward, working together, to educate the American

investor into a similar condition of immunity from the inroads of the swindling profession, and furthermore to clear up the conditions where these parasites on our national business establishments lurk and breed. From one standpoint the fight against the security swindler is naturally a selfish one on the part of legitimate business, which cannot exist under conditions where fraud goes unchecked and unpunished. But from a larger standpoint this is a patriotic duty, and despite the perennial difficulties of abolishing an evil so deeply imbedded in human nature itself we can feel assured that whatever efforts of ours in these matters can be of practical and effective value, constitute a service alike to our government and our fellow men.

NEW YORK

METROPOLIS AND CAPITAL MARKET

Address before the Chamber of Commerce
of the State of New York,
at New York City,
December 1, 1927

NEW YORK

METROPOLIS AND CAPITAL MARKET

It is with very genuine pleasure, but I must confess, with some diffidence, that I have come to address this very representative group of New York commercial and financial leaders upon the subject of New York City itself. New York is more than the largest American city—it is a national institution. So great has been its growth that year after year it has tended more and more to split up into separate communities, each with its own particular headquarters in the great city and its own particular interests and problems. Because of this fact we all tend, I feel, to lose our sense of citizenship in the metropolis itself. Too often we merely pre-suppose New York without halting either to praise or censure her, or to take thought together concerning her present problems and her future greatness. It is accordingly a very large subject which I have allotted to myself to speak upon here today, and necessarily my remarks will be tempered particularly by the activities of New York with which I am myself most familiar.

II

Invariably the newcomer to New York is puzzled to comprehend the city. From the bridge of an ocean liner coming up the harbor, the distant sky line of Manhattan is undoubtedly one of the greatest spectacles in the world, whether seen through the smoky blue mist of morning, or at night when the thousand windows of Wall Street glow through the darkness as though lit up by inner fires. No more impressive sight has ever been created solely by the industry and imagination of man. The superb majesty of the distant city at once gives the impres-

sion of possessing some inner unity and consistency. Yet when the vessel docks and we come to tread the crowded streets of the metropolis, this unity of New York City constantly eludes our search.

New York is unique among practically all the great cities of the world in that it is not the seat of a national government. London has its Parliament buildings and Westminster Abbey, Berlin its spacious Unter den Linden and Reichstag building in the Tier Garten, and Paris its historic Ile de France, Notre Dame and the Chamber of Deputies facing the Place de la Concorde. Here in New York we have only our municipal buildings, for the most part dwarfed and overshadowed by the surrounding cathedrals of commerce and private enterprise.

New York is likewise too large to possess any single dominant industry lending it a central character and significance. One may, for example, comprehend Pittsburgh from its surrounding hills rich in the mineral deposits which have made it great. Here is only the vast harbor of New York, and the slender rocky island of Manhattan now covered with the great warehouses, stores and counting rooms of our commerce, unique only in the fact that they are all-embracing. To detect any central historic thread of Manhattan's story, one naturally gravitates to the financial district, situated in the oldest portion of the city. Here there are indications of age and tradition, yet no apparent center for the life of the city so common in the older capitals of Europe. The historic churches of Trinity and St. Paul's, and the old Sub-Treasury building, are dwarfed by the ever-rising towers of commerce and finance, and they linger merely as stubborn bits of a past era, preserved against the colossal march of modern progress by our somewhat distracted sentiment for the past. I may, therefore, be forgiven when I suggest that after all the New York Stock Exchange, more than any other single institution or single building,

actually symbolizes both New York's past and present. Although possessing a continuous history of 130 years, and located upon a site at the head of Wall Street and Broad Street closely bound up with the oldest traditions of the city, it is, nevertheless, no mere museum or historical landmark today, but an active and living organization. Here more than anywhere else one may catch New York's dominant moods of aspiration and activity, and feel the economic pulse not only of the entire nation, but most of the world as well. As a mighty and an ever-changing market place, it epitomizes New York City itself—that vaster market place which serves as a gateway to the American west and at the same time faces eastward toward Europe. The very preoccupation with speculative trade is typical of the tireless aspiration of our country, its young enthusiasm, and its unalterable faith in its own great destiny.

III

New York, someone has said, is a city that constantly destroys its own past. Undoubtedly yesterday is apt to seem to us only yesterday—something to be put in the history books and taught to children, rather than to temper or guide the actions of men. Preoccupied with a future which is constantly beyond even our imagination, we neglect and forget the past. And yet, swift as development and progress has been here, the basic character of New York has not changed as rapidly as we are sometimes led to think. As a matter of fact, despite our new buildings, New York is not really so new a city. It is old enough to possess traditions in which we may well afford to take a justifiable pride. Indeed, we ourselves cannot pretend to understand the New York of our own day, without some knowledge and understanding of her past. I am, therefore, led to recall to your attention certain half-forgotten aspects

and episodes of New York's former days, which are not without significance to its present position as a national metropolis. And through this past, so largely economic and financial, runs the constant gold thread of the developing capital market on the New York Stock Exchange.

From the earliest times, New York was essentially a commercial center. The Dutch traders, who 300 years ago built their crude fort at Whitehall and their paling across the end of Manhattan where Wall Street now runs, were actuated more by the hope of profitable commerce than of either political or religious liberty. The city thus owed its very foundation, not to the fear of kings or the hatred of bishops, but to the purely economic urge for greater individual opportunity and advancement.

The growth of New York through the seventeenth and eighteenth centuries was a slow process, although during this period the city advanced steadily northward on Manhattan Island and settled the surrounding shores of the harbor and its tributary rivers. After the Revolution, New York was still rivalled, if not surpassed, as a financial and commercial center by both Boston and Philadelphia. Yet even at that time New York had its well-developed and well-defined commercial markets, and a commercial life capable of continuous future expansion. The genesis of New York commerce and finance alike may be traced back to the old water markets situated near the principal wharves of lower Manhattan, and particularly to the wharf market at the foot of Wall Street, hard by the old Merchants' Tavern. In those days the industrial revolution was new to Europe itself, and as yet scarcely an influence at all in this country. Almost all our manufactured goods had then to be imported, and were sold mainly by auction on the wharves of our principal ports. This earliest commercial market-place at the foot of Wall Street dealt in a wide variety of products—

especially, perhaps, in rum and negro slaves—two commodities in which trading is now forbidden by law. It was in this very humble and small-scale commercial market that the present vast diversified trade of Manhattan had its original beginnings.

The American Revolution left America with crippled commercial facilities, and no financial facilities at all. Not only were there no securities and no banks here, but even our currency was a wide and fluctuating mixture of local and foreign coinage. Compared with the great world market of London or the continental metropolis of Paris, New York was still an obscure provincial town. It was at this juncture that the rare genius of a New York man, Alexander Hamilton, shone so brilliantly as the first Secretary of our national Treasury. He not only effected the unification of our currency, but also the funding of our national and state debts into a 6% national bond issue—the first important security issue ever offered to American investors.

European economists have frequently pointed out, that while in Europe the development of banking almost invariably preceded trading in securities, here in New York security trading developed as early, if not actually earlier, than banking. Indeed, the first New York securities market was largely instrumental in founding the first incorporated banks and insurance companies of the city, by enabling them to obtain capital through the sale of their shares in the market. While the earliest incorporated bank in the city—the Bank of New York—was organized in 1784, it was not until 1798 that the second bank—the present Bank of Manhattan—was founded by Aaron Burr's neat subterfuge of establishing a water company whose charter permitted it to invest its surplus funds as it wished. The formation of the other older New York banks followed slowly—the original City Bank and the Bank

of America being established in 1812, and the Farmers' Loan and Trust Company in 1822.

Meanwhile a significant and rapid development had already taken place in the security business. The first trading in securities in New York occurred in the commercial auction markets, but this soon proved unsatisfactory, since it provided only a one-sided market in which competition on the selling side was lacking. At the same time, the inexperience of American investors led to the formation of a class of specialized security brokers, whose business consisted in acting as agents for private principals. Accordingly, about 1791, a small curb market in securities, conducted by these first New York stock brokers, broke away from the parent commercial markets, and established itself under an old buttonwood tree in lower Wall Street. This earliest New York security market was a very humble and small-scale affair. It not only lacked indoor quarters, but also internal organization, and common funds. Frequently, indeed, if we may judge by the scanty security quotations in the older New York newspapers, it almost entirely lacked even business. Yet many of its members bore names since preserved to the modern memory of New Yorkers by such old city streets as Barclay, Bleecker and Cortlandt. As early as 1792 this small group of original New York stock brokers drew up an agreement with each other as to splitting commissions and other matters—the first actual sign of internal organization in this market.

The business grew slowly, and finally in 1817 it was decided to organize a formal association of stock brokers and to hire indoor quarters. Accordingly the stock brokers hired a second-story room in Wall Street at the modest rent of $200 per annum, and solemnly authorized their newly elected President and Treasurer to purchase a clock for the common use and benefit of the membership. This

move indoors of the original security curb market was destined to have far-reaching effects on the development of the New York security market. For one thing, a voluntary association of brokers was organized, with a President, Vice-President, Secretary and Treasurer, which has been maintained by the New York Stock Exchange ever since. In the second place, it became possible, for the first time, to discipline members of the market by excluding them from the rooms in which the Board now met, and consequently to establish standard methods of dealing, to limit its membership to legitimate dealers and brokers, and its trading to legitimate securities. In the century which has followed, the Exchange has grown enormously in every respect, yet in the basic character of its organization and aims it is today very directly the child of the organization founded in 1817. The New York Stock Exchange has developed from comparative obscurity to a preeminent position in international finance step by step with the corresponding growth of New York City from its original status as a mere provincial town to the greatest and most swiftly growing metropolis of the modern world.

Time is lacking to trace in detail this interesting evolution both of the New York securities market and of the city where it was founded, although few historical records are more interesting and significant in an economic way than the old Stock Exchange quotations which record the rise of one after another of the nation's early industries. The New York financial market in these early years was faced with a constant struggle for existence. To the normal difficulties of administering a naturally speculative market in the unseasoned securities of a new and rapidly-changing country, there were added practically all the varieties of economic disorder known, including repeated suspension of specie payment, repudiation of debts by individuals and even states

of the Union, corners, panics, booms, and methods of corporation finance which at the time might have been cited to support the historical thesis that our earliest merchants were after all pirates. As if these difficulties were not enough, there were also added, for good measure, practically all the vicissitudes which nature itself could produce, excepting only floods and earthquakes. In 1822, for example, the scourge of yellow fever swept Manhattan and depopulated the town. The New York Stock Exchange, as well as the banks and insurance companies, the Port Warden, the Post Office, importers and exporters, merchants and even the doctors themselves, fled precipitously to Greenwich Village, and while the grass grew in the lower city streets, established a temporary financial headquarters uptown, the memory of which is preserved only in the title of Bank Street in the Greenwich Village of our own times. In 1835 fire swept the entire Wall Street district and again evicted its inhabitants. In consequence, during these years the New York Stock Exchange led, perhaps, the most hazardous and adventurous life ever given to the lot of security brokers. The market was a resident successively of basements and attics, haylofts and warehouses. Still, however, the scope of security dealings grew as the city itself expanded. To its original list of United States Federal bonds and New York bank and insurance shares, were later added the securities of canal companies and state bonds, and then the railroad securities which came to play such a dominant part in market transactions during the remainder of the nineteenth century.

With the approach of the Civil War period, all parts of the American business mechanism were subjected to terrific strain when the government attempted to pay its debts by printing greenbacks, and when gold sold at a premium. Most of the symptoms of financial and economic disorder re-

cently seen in European countries, were then present here. So weak had become the credit of our government that in 1861 United States 6% bonds were selling at 83¾ and a subsequent issue paying 7.30% had to be authorized. The foundation of our national bank system in 1863 proved powerless to cope with the fundamental evil of paper money inflation. This period of intense monetary inflation terminated in two tremendous financial crashes. The first was seen on Black Friday in 1869 when an attempt to corner gold finally collapsed dramatically under the patriotic selling of New York bankers and brokers led by Mr. James Brown of Brown Brothers. This episode provided the occasion for Edmund C. Stedman's lively poem:

"Zounds! how the price went flashing through
Wall Street, William, Broad Street, New!
All the specie in all the land
Held in one ring by a giant hand.
For millions more it was willing to pay
And throttle the street till hangman's day."

The poet concluded his stirring narrative with the final thought:

"—Let the tempest come, that's gathering near,
And give us a better atmosphere."

This poetical prayer was realized four years later in the terrible crash of 1873, when for the first time in its history the New York Stock Exchange was compelled to suspend its sessions for ten days. Severe as the panic proved, it did, however, give American business the "better atmosphere" for which Stedman had wished. The financial markets again undertook their work of distributing railroad securities, and thus enabled the raising of the enormous amounts of capital needed to build our vast transcontinental railway systems. Subsequently utility

and industrial securities likewise came upon the market, until the Stock Exchange finally became an industrial rather than a railroad securities market.

The Civil War period was not without its effects upon the New York Stock Exchange organization itself. In 1869 a consolidation occurred between the original Stock Exchange Board and two rival organizations known as the "Open Board of Brokers" and the "Government Bond Department." The combined membership of these three markets totaled 1,060 members, and when some years later 40 additional memberships were sold, the membership was brought up to 1,100 members, at which figure it has remained ever since.* At the same time it became impractical to convene meetings of all the members of the Exchange for its legislative and judicial work because of the greatly expanded size of the membership, and accordingly a Governing Committee of 40 members, chosen by vote from the entire membership, was then created. This has proved the last capstone in the basic structure of the New York Stock Exchange organization, although further specialized committees and offices have since been created as the work of administering the affairs of the Exchange has grown in volume and complexity.

IV

In tracing as I have the rise of New York City and the New York Stock Exchange to commercial and financial pre-eminence, it is necessary to recall the active competition that originally existed between American cities on the Atlantic seaboard for leadership, and some of the factors which led to the triumph of New York in this inter-city competition.

In Revolutionary times Philadelphia was the largest city in this country, and our real financial and commercial capital. This situation had been produced largely by the fact that Philadelphia at that

**Membership was increased to 1375 on February 7, 1929.*

time was the natural gateway to the west, situated as it was on the original trail which led through the mountains to Pittsburgh and the head waters of the Ohio River. It was from this original position of Philadelphia that the city so largely served as the earliest political capital for the United States government, and that the first and the second United States banks were located there.

The completion of the Erie Canal in 1825, however, effected a basic change in this situation. The first of the important American canal systems, the Erie Canal proved a great success even to its financial backers. It provided a water route from New York City up the Hudson and its tributary the Mohawk River, through the new Erie Canal to the Great Lakes. At once this became the main route into the West, and New York instead of Philadelphia suddenly became the true gateway to the new western territories. Baltimore, Philadelphia and Boston at once attempted to meet this bid by New York for commercial supremacy, by constructing westward canals of their own. But in this endeavor, the geography of the North American continent clearly favored New York, whose canal route alone could avoid traversing the mountain ranges which barred its rival cities from the Mississippi valley.

Barely ten years after the inauguration of canal building in this country, however, this entire question was again thrown open by the invention of the steam railroad, in which Baltimore and Boston were particularly active. At once another inter-city competition arose as to which city could secure the best railroad route through the mountains into the Mississippi valley. In Baltimore, the Baltimore and Ohio line was actively promoted, and Philadelphia in turn sought to pierce the mountain wall with the original westward Pennsylvania Railroad lines. But here again New York possessed the considerable advantage of what is even today advertised as the

"water level route" of the New York Central railroad, which was speedily put together by Commodore Vanderbilt. New York capital was also secured to complete the more difficult project undertaken by the Erie Railroad, of reaching the West from New York by a more direct but less advantageous route. Thus, in railroad building as in canal building, New York City held its place as the real commercial capital of the new country, and its financial significance grew along with its augmented commercial importance. Nor can the triumph of New York be attributed wholly to the fortunate circumstances of geography. Even from the earliest times, the New York commercial and financial leaders were adventurous and enterprising. The new capital market of New York City also enabled funds to be continuously raised for the expansion of New York City's transport routes westward, and the bankers and brokers as well as the railroad engineers were deserving of praise in their successful accomplishment.

New York City, it is true, was by no means alone in possessing a stock exchange. Institutions similar to the New York Stock Exchange had developed as early, if not earlier, in the rival cities of Philadelphia, Boston and Baltimore. But the New York Stock Exchange tended to outgrow these rival markets because of the greater volume of business which New York's commercial supremacy constantly tended to direct into Manhattan. Nevertheless, in the beginning all American stock exchanges were to a large extent local institutions, because of the impossibility of speedy communication over the considerable distances in this country. Suddenly this factor ceased to exist, due to the invention of the telegraph by Samuel F. B. Morse, erstwhile portrait painter of Washington Square. Due to Professor Morse's epoch-making invention, Wall Street prices began to be distributed among the settled portions of this country during the Civil War period. Shortly after

the Civil War, the telephone and the stock ticker were developed. These inventions in turn made it possible for the security business of the nation to a greater extent than ever before, to gravitate into the New York markets. For one thing, New York Stock Exchange firms began to establish branch offices connected by private wire with their headquarters in Wall Street. The first of these offices on record was set up at 23rd Street, and it is related that curious customers would first order the purchase of securities at 23rd Street, and then drive hastily to Wall Street by cab to see if their orders had really been executed. From this small beginning, branch offices of New York Stock Exchange members have spread all over the country and indeed beyond its borders, and are today a recognized and accepted facility in the transaction of business in securities all over the nation.

The electric stock ticker instrument was finally perfected by the efforts of Edison and other less celebrated inventors. As time went on, stock tickers were established at greater and greater distances from Wall Street. Quotations made on the New York Stock Exchange are received almost simultaneously in the other principal cities of the country. Apart from the inevitable centripetal tendencies of the security business in seeking some common center and some common market, it has also been due to the efficient facilities for the business constantly provided by the New York Stock Exchange and its members that the New York security market has attained its present leading position in this country. According to tax statistics, about 90% of the shares sold in the United States are sold in New York City, and bond sales are also largely centralized here, although perhaps to a lesser degree. New York has possessed natural advantages in this competition for American financial leadership, but its institutions and its business men, I feel, have also played highly signi-

ficant parts in this development by their continued efforts for the improvement of the market's facilities.

V

Many years before the New York Stock Exchange could with any justice term itself an international market, it nevertheless was profoundly affected by foreign economic forces. The trans-Atlantic cables placed the market immediately in touch with the foreign financial centers, on whose stock exchanges our own securities were before the war very frequently listed. In those days, when the United States was the largest debtor nation in the world, the foreign holdings of our securities were large, and occasionally the dominant market for them actually existed abroad rather than in New York. The arbitrage business, whereby prices here and abroad were held close together by special dealers, was very active before the war, and particularly the course of prices in American securities in London then exerted a considerable influence upon their tendencies here.

At the outbreak of the war in 1914, the New York Stock Exchange was compelled to close, lest the liquidation from abroad of American securities here should bring on a disastrous panic. When the Exchange reopened subsequently, this liquidation occurred, but gradually and without unfortunate financial effects here. As European holders sold their American securities back to our own investing public, the great mortgage held by Europe on our industry was gradually lifted. At the same time, America for the first time began to absorb the securities of European countries, and thus began its career as a creditor nation. This trade in capital was naturally invisible. It could not be detected upon our wharves or in our commercial markets. Yet its enormous importance to the entire economic status of the United States has been rec-

ognized by all competent observers. And again New York City and the New York Stock Exchange have served as a gateway and harbor for this great invisible trade in capital and the effects of capital. Since our own participation in the war, investment in foreign securities has of course enormously increased, and on the New York Stock Exchange list today an unusual diversity of foreign investments have found their place.

It is interesting to note certain changing trends within this movement of American capital abroad. When our foreign investing began, American capital was timid and foreign credit weak, and in consequence of this only government dollar bonds for the most part were issued in New York and listed on the New York Stock Exchange. With the improving economic conditions in Europe and the lessening timidity of the American investor, foreign corporation dollar bonds began to appear here. Lately the funds of the American investing public have proved so ample, and economic conditions in Europe so largely restored, that we are beginning to see even the shares of foreign corporations issued in the New York capital market and listed on the New York Stock Exchange. This final development rounds out the genuine international character and facilities of the New York capital market. While our whole experience in foreign investments has been very limited in point of time, nevertheless I feel that the New York capital market is rapidly formulating high standards for the carrying on of this important work. The New York Stock Exchange, for example, is less concerned with becoming the greatest security exchange in the world purely in point of size, than it is with the quality and character of its operations. A great responsibility indeed rests not only upon the New York Stock Exchange, but also upon all other parts of the New York capital market, to safeguard as far as possible the investors of this

country in their foreign as well as in their domestic investments. Nevertheless, it is interesting to note that the New York Stock Exchange today in respect to the volume of its foreign listings, is practically on a par with Paris and Berlin, and is surpassed only by the century-old international security market upon the London Stock Exchange. Obviously a great destiny lies before financial New York as an international market for securities from all quarters of the globe.

VI

Having traced the growth of financial New York both from the national and international point of view, it is interesting to note the scope of its principal stock exchange today, and the ramifications of its activity in New York City business generally. Here figures are largely available, and I trust you will pardon my stating a few of them.

On September 1, 1927, the total market value of all securities listed on the New York Stock Exchange was $82,667,000,000—obviously a considerable fraction of our total national wealth. In this vast aggregate of capital in the form of securities can be found almost all manner of significant business enterprises in this country, and to an increasing degree the obligations of the leading industries and governments abroad.

As illustrating the present scope of the New York Stock Exchange system, on June 1, 1927, our members were operating 962 branch offices in 292 cities located in 41 different states of the Union and in four foreign countries. These branch offices are for the most part connected with the headquarters of their firms in Wall Street by private leased wires, which in the aggregate amount to many thousands of miles. By means of this great network of private telegraph lines converging on Wall Street, a vast flood of security business is attracted into the New

York center—a fact not without effect throughout New York City business.

At the same time, wires leading in the first instance from the Stock Exchange floor operate 5,547 stock tickers and 889 bond tickers in almost all parts of the country, and thus prices made on the Exchange floor in New York are rendered available to American security buyers and sellers at vast distances from this city. Owing to a recent expansion of our ticker system, our quotations are now available in San Francisco, several thousand miles away, only a half-minute on the average later than when they are reported in New York City itself. It has been by the establishment of efficient and reliable services of this character, that New York has justified its present place as the leading financial center of the nation. Other figures relating to other phases of the activities of the New York Stock Exchange and its members could readily be given, but I do not wish to inflict too many astronomical figures upon you. My only desire in alluding to such statistics at all is to stress the fact that New York City's dominant position in American finance is no mere accident, nor the mere enjoyment of an original geographical advantage, but that it has been continually built up and fostered by all the devices which science has made available, and by a constant desire for improvement and betterment of its services in all lines.

The wide scope and continuous activity of the security market in New York is not simply a matter interesting and gratifying to Stock Exchange members; it exerts a wide and far-reaching effect on almost all lines of New York City business. Scarcely any form of New York City business enterprise exists which does not benefit by its close access to the capital market here, although sometimes such benefits are indirectly derived. We all came to realize this fact more clearly than ever before during the paralysis of business in the fall of 1914, when the

New York Stock Exchange was closed. Without attempting to enter into an elaborate analysis of this inter-relation between New York's financial and other business, I would call your attention to a few activities in which the New York Stock Exchange has been an important factor in attracting to this city.

It is obvious that the concentration of the security market business here gives employment to many millions of dollars of American capital, and to many thousands of men, from messenger boys up to highly-paid experts. Also, many of the leading American corporations maintain a head office here because of the nearness to the capital market. This is naturally reflected in the purchasing which goes on in New York's stores and shops, in the rentals which are paid in this city, and in a wide variety of essentially non-financial New York City business, and it adds enormously to the prestige of New York City as a commercial and financial center.

On September 1st there were listed on the New York Stock Exchange 1,081 share issues, each of which, due to the regulations of the Exchange, must maintain registrars, and transfer agents or offices, in this city. The significance of this fact to the New York banking business is obvious. Likewise, for the 1,481 bond issues listed on the Exchange, authenticating agents in New York must also be maintained in each case.

The location of the active capital market here tends to make New York City the chief center for the flotation of new security issues, and to attract hither the funds needed for the enormous dividend and capital payments now made on American and also foreign securities. For the same reason, financial advertising and publishing have their headquarters in this city, as well as many varieties of intelligence services for the American business man and investor. Foreign branch banks and branch secu-

rity firms are likewise led to establish themselves here.

A final effect on New York City of its preeminent natural position is the handling here of the large security collateral loan market, where securities are carried awaiting sale like the stocks of goods in a huge dry goods establishment. This security collateral loan market is one of the oldest and most important branches of the American money market. It draws funds to New York City from all over the United States and indeed from abroad, and provides the inherently safest short-term investment for such funds here that has ever been developed in this country. It is a factor of no small importance and significance in the functioning of the entire financial center here, and the securities in it used as collateral are to a very large extent confined to the issues which possess ready negotiability provided by listing on the New York Stock Exchange.

VII

New York is veritably a wonder city, old and yet continually renewed, and pulsating with constant change—a city where all things are possible and where progress and change are continuous. Possessing, perhaps, the greatest natural harbor in the world, it is the permanent gateway of the richest continent in the world today, not only in the physical commerce borne into its harbor and over its wharves, but also in the invisible trade in capital. Its growth has been without precedent, and its potential possibilities are without apparent limit.

New York City differs from the other great cities in the world not only in size but also in kind. It is a city where superlatives understate. It combines, though often in intenser degree, the magnitude of London, the immediate access to the sea possessed by Venice, the rocky foundations of Edinburgh,

and a passion for rebuilding outrivaling even Rome. Added to all this there is a spirit of virile and restless energy, an impatience with delay, and an aspiration for human betterment, which are all its own. Untrammeled by the dead hand of past conventions and outworn necessities, the city rises triumphantly over the confines of its surrounding rivers, and faces the future with a justified confidence in its ability forever to create, to invent, to grow and to endure. And already in our own times the stern energy of the pioneer epoch during which the city has won its way to preeminence, has been happily turning to the creation of beauty as well as utility. A new vertical type of architecture has evolved here which not only solves the material problems of our daily life, but also truly expresses the broader aspirations of man to rise out of the confines of material circumstances. No city symbolizes as does New York, the triumph of man over nature. What was undertaken as an architectural necessity for commerce, has been converted into ever-expanding vistas of a new, superb and fantastic beauty. New York today provides a stirring call to the human imagination, and an irresistible appeal and urge to the creative powers of man. It symbolizes to the entire modern world in lasting and lofty steel and stone, all that is daring and magnificent in the aspirations of the true spirit of America.

THE COMMON PURPOSES OF BRITISH AND AMERICAN FINANCE

Address before the American Chamber of Commerce in London, London, England, March 20, 1928

THE COMMON PURPOSES OF BRITISH AND AMERICAN FINANCE

I very deeply appreciate the privilege of this opportunity to address the members and guests of the American Chamber of Commerce in London. To me, it is a particularly agreeable thought that, month in and month out, this admirable organization is steadily and constructively working for a more complete mutual understanding, and a closer accord, between the United Kingdom and the United States. The ultimate value of efforts such as these cannot be too heartily applauded, since so many and such vitally important problems facing the modern world, depend primarily upon a continual harmony of thought and action between the English-speaking peoples.

II

Today the community of interest between Great Britain and the United States is closer than ever before, if only because of the fact that both countries are international creditor nations. But so recent and so swift has been the evolution of the United States into an international lender, that at the outset a few words of comment on this score are necessary in the cause of closer mutual understanding.

American commerce and finance were almost wholly founded upon customs and practices inherited from the mother country. Even a century ago, the aim and direction of American economic efforts were mainly determined by the familar precedents of British law and custom, by the old British traditions of commercial integrity and fair play, and by the instinctive British preference in matters of trade for

free individual initiative as against impersonal and bureaucratic methods of governmental control and supervision. These basic principles, together with the constant model of the vast free markets of London, constituted a factor of overwhelming importance and enormous advantage to financial America all through the nineteenth century. In this matter of early financial and commercial training, therefore, we can scarcely plead the lack of sound precedents to follow during the earliest and most formative years of our national existence.

But if our business methods and our economic philosophy were thus readily obtained from Great Britain, their practical application and realization had to be worked out under economic conditions far different from those obtaining here. Early in the nineteenth century the United States undertook the ambitious task of colonizing and settling an enormous and primeval continental area. The needs for capital which this gigantic national task entailed, far outran our own ability to provide it. In consequence, the United States speedily developed into the greatest international borrowing nation that the world had ever seen. In addition to absorbing practically all the savings of our own people, enormous aggregate sums were borrowed from the investors of Great Britain, and even from those of certain Continental nations. So long did this situation continue, that even in America it became customary to assume that it would last indefinitely, and that we would never see the day when American capital could not be readily employed within our own national boundaries. Even the tendency for some American funds to flow into enterprises in the neighboring countries of Canada and Mexico did not change our conviction that foreign investments were something with which America had no real concern, and perhaps never would have.

Nevertheless, even before the Great War, America

was quietly yet steadily approaching a condition of economic maturity. It has only been recently, however, that the significance of this fact has been realized by Americans themselves. The century-old task of establishing facilities for transportation and production throughout our vast continental area was nearing completion. In 1910, for example, the main lines of our huge railway net had all been permanently established, and the total mileage of railway track in the United States was greater in that year than it has been at any subsequent time. Also, on the very eve of the Great War and after a generation of controversy and delay, the United States established its Federal Reserve banking system—that great and indispensable bulwark to our national credit in the perilous and unprecedented days to come. Likewise, before the outbreak of the war, our major industries had already consolidated and organized themselves into powerful and efficient productive units. These developments were all signs and tokens of an approaching era when our economic establishment would be able to maintain itself without further foreign borrowing, and when by reason of its own economic evolution the United States would become able not only to supply all its own needs for capital, but also to find itself in the possession of a surplus of capital which could be regularly loaned abroad.

I stress the course of these events in America prior to 1914, because of the common belief on both sides of the Atlantic that the present position of the United States as an international lender has been entirely due to the war. Actually, no conclusion could be more fallacious. The short-lived and largely artificial prosperity in the United States in 1915 and 1916, was rapidly blotted out by the enormous wasteage of capital entailed by our participation in the war later on. A more critical examination of the United States today will reveal the same scars of economic loss and waste through war as are borne

by all other European belligerent powers. Five days ago, when payments on American income tax were due, few sensible business men could well agree with the thesis that our recent national prosperity was founded on the war. Indeed, the serious business depression which swept the United States in 1919-1921 should be ample proof that our ability to lend funds abroad today can scarcely be attributed to the war. Actually, our foreign lendings have resulted from efficient production and constant economy—the only true source of capital in the world. From this fact it also follows that America's present ability to lend funds abroad is no mere flash in the pan, but in reality the climax to a century of steady economic development which was really inaugurated by the industrial revolution begun in Great Britain by Arkwright and Stevenson.

III

History seems to show that new economic philosophies do not forecast future business conditions, but are evolved—sometimes rather tardily—from new conditions already in existence. Theory in this way follows rather than precedes practice, and it remains the function of the realistic economist to explain the past and present rather than to predict the future.

When it is remembered how unique to Americans is an economic situation whereby sufficient capital is being generated within the United States not only to answer all our own needs but also to lend abroad, and how suddenly this situation has developed, much of our own confusion of thought in international affairs can more readily be understood. It is necessary for us to re-adjust our whole economic philosophy, developed over the past century and longer, to the realistic dictates of this new circumstance. Our financial markets, for example,

apparently face the unprecedented and—to us—the paradoxical condition of a scarcity of investments rather than a scarcity of funds. Recent events have moved somewhat too rapidly for our accustomed modes of economic thought; this extraordinary economic reversal of our national status in a single decade promises to have most far-reaching results in the organization and habits of American finance, and to call for a thorough over-hauling and revaluation of many of our oldest and most familiar financial methods and practices.

This evolution of the United States into a creditor country, which has occurred so suddenly and whose consequences still prove so strange and unfamiliar to us, makes it more necessary than ever before to arrive at a closer and more intimate accord with Great Britain—the most extensive holder of foreign securities in the world. In the path of such a closer financial understanding between our countries lie several minor obstacles which frank recognition and definite effort can readily overcome. Many of these sources of financial misunderstanding arise from the very different ways in which London and New York have become international lending centers. The development of the vast international investment interests of London was gradual and slow, occurring as it did throughout the whole nineteenth century. In New York, on the other hand, this development came almost over night, and has grown at an unprecedented rate. It has therefore been inevitable under the circumstances that the financial methods obtaining in London and New York should still differ quite widely, despite their obvious community of interest as creditor centers, and from this difference the task of mutual understanding has been rendered more difficult.

I scarcely need remind my friends in the City that, with a few exceptions, there has not been sufficient time in New York for specialized houses of issue

to develop as they have in London. American investment bankers are therefore less apt to possess a complete knowledge of the economic and financial traditions of a given foreign borrower, than is the case here. Our firms also, I think, show a stronger competitive tendency than is usual among British issuing houses.

It is also a significant fact that in Great Britain the link between commerce and finance has always been very intimate, and that British mercantile contacts with foreign countries have very frequently developed gradually and naturally into financial contacts. In the United States, on the other hand, foreign investment has resulted rather from the sudden and enormous overflow of our internal reservoirs of capital, directed into foreign securities only occasionally by our past commercial experience, which our commercial self-sufficiency and our isolated geographical position has in the past largely inhibited. The American banker and business man of today is in most things by no means over-credulous or lacking in practical vision. After all, the nineteenth century imposed upon our people a wide diversity of economic experience, including booms and panics, periods of prosperity and periods of acute depression, and even civil war and unsound currency. This has been a hard training school for American business, from which it has, I believe, enormously profited in financial and commercial sagacity. Nevertheless, it is frequently difficult for the American banker or the American investor today to judge foreign conditions even from the numerous lessons derived from our own varied economic experience. Some investors still show a tendency to lump all foreign securities together, and generalize concerning them in one breath without discrimination. This, however, is in my opinion a tendency which is rapidly passing.

A final contrast between the international investing

methods of Great Britain and of the United States consists in the fact that through the nineteenth century most British foreign investments were made in new and growing foreign countries, many of which were of course British colonies. Due to the war, however, America has been largely called upon to invest her surplus funds in the older and former creditor nations of Continental Europe. Very recently, however, there has been evidence that the outflow of American capital might be destined to take a different direction, owing to the steady economic recovery of the nations of the European continent. Certainly it would seem a more normal economic process—and one for which American experience has unquestionably better fitted us—for our surplus funds to flow into the new pioneer countries of the world.

I have mentioned these several basic peculiarities of America's recent course as an international investing nation, because I believe that these conditions give rise to a particular need for closer association between London and New York in the business of foreign investment. If the surplus capital of the United States develops undue pressure upon our financial markets, it may, through inexperience be loaned recklessly and incautiously, with the result of doing considerable harm to Great Britain, as well as to our own country.

IV

During the nineteenth century, London was for so long the almost sole source of international capital that it was able to establish financial standards for borrowing which were largely effective the world over. Indeed, this has been one of the greatest recent contributions of Great Britain to the civilization of the world. Through sometimes bitter experience with unsatisfactory foreign investments, the London finan-

cial community came to formulate sound standards of financial practice for foreign governments as well as for foreign business enterprises—standards which were based on fair play and commercial integrity. Refusal by the borrower to comply with these financial standards set by London practice, meant ultimately an inability to borrow further funds. The London market could and did close its doors against fraudulent or reckless borrowers, and refuse to make further loans until sound methods were employed. In this way, the London financial market was for many years a powerful deterrent to needless political disturbances and to unsound fiscal policies by foreign governments, as well as to corporate recklessness, shiftlessness or dishonesty, all over the world. Borrowers frequently protested against the imposition of these financial standards, despite the fact that in the long run they themselves no less than British investors stood to lose by breaches of them. Nevertheless, since London was so largely the sole source for foreign capital, the London market had enormous influence the world over, and was a factor for peace and ultimately for better standards of living and government almost everywhere.

Today the United States has suddenly begun to share this international lending function with Great Britain, and because of this fact it is highly important that American finance closely cooperate with the older financial community of England in maintaining sound standards for international lending. Undue competition between London and New York in this respect might well result in a deterioration of financial methods employed by borrowing governments and business enterprises in many parts of the world. The need for closer accord between British and American finance is therefore not merely a pious sentiment, but a most important practical question, with large economic consequences almost everywhere. In this effort toward broader and more intimate finan-

cial understanding, our central banks have already shown the way with admirable foresight and mutually beneficial results. I am also happy to state that in certain matters not without importance to stockbrokers, the ability of the London and the New York stock exchanges to cooperate in a similar way has already been demonstrated to their mutual advantage. It is also to be hoped that other English and American financial institutions and concerns may show an increasing tendency to consult with each other frequently, to study each other's situation more fully, and, as far as possible, to cooperate in matters of trade and finance. It would seem to be a most sound and constructive development, if the large capital resources and business energy of Americans could be united with the high ideals and long experience of the British, in the vast financial tasks which face the modern world.

In this matter of commercial and financial standards, England and America have, I feel, a common interest from a purely domestic standpoint. In America we have maintained during recent years a very active campaign against swindling in business, and particularly against the selling of fraudulent securities. The experience which the New York Stock Exchange has had since it initiated this campaign, has led us to believe that some of the smooth-tongued individuals who cause so much havoc among the American investing public, occasionally pay a visit to this country to sell their fraudulent wares. As far as financial swindling is an international problem, naturally it can be effectively met only by international methods of cooperation. The financial swindler strikes a deep and dangerous blow at the whole structure of the modern security business, and the evils which result extend even beyond his immediate victim to the whole financial community. From time to time the English press has reported the occurrence in this country of security frauds which

have an unfortunately familiar sound to those of us in New York who have been striving to drive the financial swindler out of business. I sincerely hope that methods may be arrived at for international cooperation against the sellers of fraudulent securities which may be of mutual benefit to us both. Certainly I can unreservedly pledge the wholehearted assistance of the New York Stock Exchange in any such effort.

V

A final and common purpose shared between the British and American financial communities today arises from the considerable problems connected with the maintenance and improvement of the modern capitalistic system, of which our two countries are rather particularly the present-day trustees. The war period accomplished at least one useful purpose, in that it quite definitely disposed of the challenge of socialism as a superior method of economic organization. The war, in fact, afforded a supreme test of the essential soundness of our prevailing economic order, and, despite the doubts which were entertained of its permanence shortly after the Armistice, there is little doubt today that capitalism has amply justified itself. Communism, which during the war and post-war periods was actually tried on so large a scale and in so many different countries, has quite definitely proved itself an exploded and discredited theory. Socialism, when put to the actual test, only aggravated the very evils against which it had protested so vehemently.

Nevertheless, certain radical criticisms of the existing capitalistic order—particularly in regard to its wastefulness and its inequalities in the distribution of wealth—cannot be so easily disposed of, even though socialism itself has been found to provide no genuine remedy for them. There has in consequence

been a feeling on the part of many liberal-minded people on both sides of the Atlantic, that the recent undoubted resurgence of capitalism and of individual initiative, inevitable for practical reasons, nevertheless represents a hopeless resignation to old evils which had long accompanied the capitalistic order. With this view I cannot myself agree, for I feel that a new and more broadly beneficial era is now opening before the capitalistic system.

The true defense of capitalism is not merely the negative argument that at least it avoids the horrors and suffering entailed by communism, but rather the positive view that its own evolution entails increasingly broad benefits to everyone. Owing to especial circumstances, the tendencies of modern capitalism to share its benefits more widely than every before, have developed with particular rapidity in the United States. Nevertheless, it is a very considerable error to conclude that this is a development peculiar to America. Many British bankers and economists of note have for some time reported a similar trend in Great Britain, and have not hesitated to declare that despite the existence of serious financial and economic problems here, nevertheless the average standard of living was never so high in this country as at the present time. More recently, somewhat similar views concerning the leading Continental countries have been expressed. We all have come to the realization that to place the employee and the wage-earner in a position where he can become a more effective consumer of goods, is, apart from the benefit to him, to increase and stabilize the profits of capital itself. In reality, this is only a new application of the old British mercantile theory that it does not pay to impoverish one's customers, and that one must yield profit to others if he hopes to obtain them from others himself.

If it is, then, to be a further test of the capitalistic order whether it can more broadly distribute its

benefits, evidence exists that considerable progress in this respect has already been made on both sides of the Atlantic. We have all passed through the exhilaration and excitement of the war period, and through the era of disillusionment which followed the Armistice. Yet a very sober view of the future possibilities of our present economic order still justifies confidence and even enthusiasm concerning its ultimate social consequences.

Finally, the capitalistic order faces an age of stabilization and conscious control, whose manifestations have already become apparent on both sides of the Atlantic Ocean. Financial men everywhere, I think, are inclined to admit that there is much truth in the criticisms which have frequently been levelled against the needless uncertainties and instabilities of the capitalistic order. Scientific methods applied in this field can produce vast benefits throughout the modern world. Naturally, efforts to stabilize business conditions, if they are to be everywhere effective, must be exerted upon an international scale. If modern society can pursue the lurking germs of disease into the jungles of Central Africa or Central America, surely it would seem that progressive financiers might show a similar energy in endeavoring to eliminate those economic factors of waste and inflation which in the past have swept across the modern world, leaving depression and catastrophe in their wake. And in any effort of modern finance looking to greater international stability, very obviously there is a primary need of cooperation between the leading financial communities of Great Britain and America.

These issues cannot be considered as merely vague and academic. They are of the greatest practical significance to us all. It is therefore of primary importance that greater mutual understanding should exist between the English-speaking peoples, and that we should all more effectively mobilize our energy

and our intelligence in the common task of making the world a better place to live in.

VI

It is surely no original thought, but an obvious fact borne home to all of us by the events of the past few years, that we are today living in a world whose distances are shrinking before the new inventions and discoveries of science. Through the new miracle of the radio, the chimes of Big Ben may now be heard in countless American homes, while for better or worse the music of American orchestras and bands has invaded the British fireside. It is well for us, as practical men, to remember that market quotations, no less than music and oratory, can be thus transmitted around the world today, and that this new invention of the radio has a profound economic significance to us all. While as yet few of us perhaps have employed the trans-Atlantic telephone, nevertheless we all no doubt cherish the hope that presently its rates can be sufficiently reduced to place it at our daily disposal. The projects already going forward not only for four-day ocean liners, but even for forty-eight hour dirigibles, indicate that trans-Atlantic transportation no less than communication is likewise very rapidly obviating the spaces of the modern world. This momentous phase of the age in which we are living has been, of course, dramatically symbolized in the marvelous feat of Lindbergh last year, in crossing the Atlantic in a single airplane flight.

It is doubtless beyond human wisdom to realize today the ultimate economic significance of these remarkable advances in international communication and transportation which are being effected under our very eyes. But the situation at least recalls the wise words of an eminent American economist, the

late Professor William G. Sumner of Yale, who once declared that our scientific knowledge of the laws which govern the life of man in society must keep pace with our scientific inventions or we should find our social tasks grow faster than our knowledge of social science, and that our society would break to pieces under the burden. Human judgment does not always develop as rapidly as economic circumstances in such matters, as we may realize today from the ridiculous talk of possible future naval wars between Great Britain and the United States, as well as from other equally absurd statements of narrow minds and minor politicians. Irresponsible assertions of this sort, passed back and forth across the Atlantic, irritate and annoy all sensible folk in both countries. It seems utterly unnecessary to dignify such irresponsible chatter as this with a serious effort of disproof. The actual relationship that exists between Great Britain and the United States is too clearly and unmistakably revealed all along the vast borderline between Canada and the United States—one of the longest international borders in the whole world, and closely adjacent to the largest cities of both countries —which, for several thousand miles, lies unguarded by a single cannon pointing at the heart of a neighbor, or by a single fort frowning down upon the open routes of free intercourse and trade.

Nevertheless, it is sometimes imperative for both British and American business men to call attention to the realities. We all have shown only too much of a tendency to abandon the field of public discussion to irresponsible sensationalists and talkative trouble-makers. Every modern country, I imagine, is afflicted with those small and precious groups of earnest thinkers which specialize in noisy declamation, and which mistake mere perversity of opinion and disregard of fact as the signs of genius and masterly intellect. This curious folk can usually be depended upon to stir up dissension and promote

international misunderstanding on every possible occasion. Both British and American business men are by this time also fully aware of the foreign professional promoters of international discord and strife, whose earnest desire for dissension between the English-speaking nations has frequently enough been no mere intellectual whimsy, but an elaborate plotting backed by much gold and promoted on many continents. It is well, I feel, for those of us who happen to be in sufficiently close contact with the realities of modern international trade and finance, to go to some effort in halting this continual misinterpretation of the Anglo-American relationship. Fortunately, such conspiracies against our mutual good-will have in the past fallen on barren soil both here and in America, and the common sense of our peoples has hitherto been little impressed by the elaborate subterfuges or owlish wisdom of these gentry, nor indeed is it likely to be.

In this matter of fostering a more intimate accord between England and America, there is, I feel, a particular responsibility imposed upon our merchants and our bankers. For trade, whether commercial or financial, is undoubtedly the greatest solvent for the eternal difficulties which different nations perennially experience in attempting to comprehend each other. I have little patience with that present-day school of historians who carry the fashionable "economic interpretation of history" to such lengths, that they conjure forth future irrepressible conflicts from every trifling and unimportant trade dispute between nations. This is neither history nor political economy, but the very absence of both, and the actual truth concerning international commerce and finance is far otherwise. The steady international exchange of merchandise and securities between nations is, in point of fact, one of the most constructive forces in the curbing of international contentions and misunderstandings. It is for this reason that the

American Chamber of Commerce in London, as well as the similar British organizations in America, are to be congratulated for quietly yet effectively cementing closer bonds of trade and fellowship between our countries. Such efforts possess vastly greater consequences for international good-will than even their own officers probably realize.

In recent years, there has been much discussion as to the comparative importance of London and New York in modern finance. Personally, such discussions have always seemed to me particularly futile and useless. We should rather concern ourselves with the task of seeing that London and New York work together more constantly and more thoroughly than ever before, to provide effective financial leadership in the world of today and of tomorrow. In the great common tasks which face the modern world—in the elimination of the horrors of armed strife or the useless bickerings and misunderstandings which threaten peace, in the avoidance of the needless insecurities of public order and private trade—there is need that financial London and financial New York labor shoulder to shoulder in laying the lasting and effectual foundations for higher spiritual and material standards throughout modern civilization and modern society.

THE ANGLO-AMERICAN RELATIONSHIP

Address before The Pilgrims,
London, England,
March 29, 1928

THE ANGLO-AMERICAN RELATIONSHIP

I appreciate very deeply the generous invitation of The Pilgrims to be here today. At the same time, I must confess that I received the invitation with considerable surprise. Unless I am mistaken, this distinguished audience, which has listened to so many famous diplomats and statesmen, is today for the first time listening to a stock broker. It may, of course, be only a coincidence that no member of my profession has previously been invited before the Pilgrims, yet I am persuaded that there has been a very good reason for this attitude on their part. For, as a matter of historical fact, it was largely the stock brokers of London who enabled the first Pilgrims to set sail for New England. Their effort to colonize that part of the New World, I would remind you, was organized in the beginning as a joint stock venture known as the "Massachusetts Bay Co.," whose shares in their day were no doubt a feature of your early stock markets in "Change Alley."

It might seem from these circumstances that the Pilgrims would ever afterward have cherished a warm spot in their hearts for the tribe of stockbrokers. Unfortunately, this has not been the case. For the share dealers of 300 years ago made the great mistake of selling many of the Massachusetts Bay shares to the Pilgrims themselves, and—at least as I recall the matter—every Pilgrim father had to show his share certificates before he was allowed on the boat at Plymouth. Whatever one may say about the successful colonization of New England, which the Pilgrim fathers brought about, it is a sad but indisputable fact that the Massachusetts Bay shares never

paid any dividends and ultimately joined the limbo of exceedingly bad security investments whither so many other share enterprises have followed them. It is therefore little wonder that the Pilgrims have felt a certain prejudice against stockbrokers ever since. I can only hope that my presence here today may in a measure help to dispel and allay this feeling, and make amends for the errors of my profession three hundred years ago. Certainly I must very carefully avoid giving any "Tips" on the stock market to the Pilgrims today, or the stockbrokers may again find themselves barred from these most interesting and enjoyable luncheons for another three hundred years.

II

The purpose of this Society in striving for better Anglo-American relations is, of course, well known and it is naturally incumbent upon your speakers to allude to this subject. This is no light undertaking for a newcomer to your hospitable board like myself. For it is not unlikely that ideas and sentiments in respect to the relations between the United Kingdom and the United States, which may seem sufficiently original to me, may prove to this experienced audience only a rather conventional and monotonous repetition. I can fully sympathize with the old Latin poet who wrote "May those people perish who have expressed all our opinions before we had the opportunity of doing so." Nevertheless, the Anglo-American relationship is a large topic, and—for all the brilliant discourses which the Pilgrims have no doubt heard upon it already—there still must remain something to be said upon it.

One of the difficulties into which Englishmen and Americans, in their attempt to understand each other, constantly fall, is the tendency to assume that England and America are really one country. This is a fallacy into which an American of English descent

like myself finds it particularly hard to avoid. I must confess that whenever I disembark at Southampton I very much dislike that word "Alien" stamped on the top of my landing card. And yet that way lies the merely sentimental view of the Anglo-American relationship, and the indefinite repetition of the well worn platitude of "Hands across the Sea." We cannot turn back the course of history in this way, gentlemen—we must not blink at present day realities. The United Kingdom and the United States today are two different countries, with different forms of government, a different economic life and outlook—and (if you will pardon an outlander for making the remark) even a different sort of climate! Unless we begin with the clear realization of this basic fact we cannot hope to promote effectively that closer relationship and accord, that more intimate and sympathetic understanding, between our respective peoples, which all sensible Englishmen and Americans today sincerely desire.

Yet, paradoxically enough, we will equally miss the truth if we fail to recognize the important fact, that the difference between our two countries is of a quite special and peculiar kind. In recent months a very penetrating and able French critic of America, Professor Andre Siegfried, took occasion to comment at length on just this point in his brillant and enlightening book "America Comes of Age." Professor Siegfried states that ordinarily England and America took a particular delight in laughing rather ill-humouredly over each other's peculiarities, and in grumbling constantly about the activities of each other's public men and public politics. But, the French critic went on to explain, any other nation would make a capital mistake if it tried to share in the jest. The friction and discord between England and America is thus a rather private affair between them, and is really based upon the privilege of kins-

men to be impolite to each other. Other nations who might feel inclined to join in these disputes and bickerings should be as scrupulous about attempting to do so as the famous Irishman who entered a New York restaurant where a lively fist fight was in progress, and inquired whether it was a private row, or whether anyone could join it.

It is, after all, this continual paradox—that while the differences between England and America are real and distinctive, yet they are by no means as great as those which separate the English-speaking from the other nations of the World—that leads to such confusion of thought and action in respect to Anglo-American relations. Both Englishmen and Americans have as a rule an endless charity for the habits of other countries whose customs and traditions are wholly foreign to their own. We neither of us show much irritation at the ways of other lands; their failures we pronounce as quaint and interesting, their follies as signs of individuality to which every distinctive nationality has a perfect right. But we both fail signally when we try to do this with each other. The American who comes to England encounters what seem to him many obsolete methods in business and a lack of that efficiency upon which rightly or wrongly we set much store. With our convictions and our training we cannot readily approve these things but what is more, we cannot simply smile and say, "How quaint," "How picturesque." With that instinct for righteous crusading for which our Pilgrim forbears were after all so largely responsible, we itch to take a hand in these matters and set them right. Very naturally, such efforts are rarely appreciated here.

Now, the Englishman who comes to America has a similar experience. Here, he feels, is a vast country of marvellous natural resources and riches, and a people mainly of the old English stock who, by reason of their geographical isolation and their economic

sufficiency should be enabled to carry forward along every line the standards of civilization and society. But this feeling,—so natural when first beholding the great and unique New York skyline from the lower harbour—soon gives way to an irritating perception that after all America is still far from Utopia. Now not all the Pilgrims actually left England—witness, for proof, this gathering today! Englishmen share with Americans the old Pilgrim love of a righteous crusade. The British cannot quite bring themselves to adopt a purely tourist's attitude of impersonal amusement at the follies and weaknesses of a people who speak their own language. With the kindest intentions in the world the Englishman in the States cannot well prevent himself from pointing out to the natives, just wherein their errors lie. His own vanity cannot endure the thought that his racial cousins should make fools of themselves. And, naturally again, the vanity of the American cousins stands in the way of an appreciative reception of his remarks, even though they may be pearls of wisdom.

III

From what I have said, it might seem that I was a thorough cynic as to the possibilities of a more harmonious relationship in the future between England and America. I can, in fact, almost hear some of the more traditional Pilgrims in the audience murmuring to themselves, "This is what comes of inviting a stockbroker to our Meetings." I frankly confess that I cannot look forward to the day when Englishmen and Americans will invariably be polite to each other, and will invariably suppress all tendencies to criticize each other's ways. But this is not cynicism. I, for one, sincerely hope that such a day never will arrive. Politeness and urbanity may be much, but they are not everything. Frank and well-intentioned opinions, even though vigorously ex-

pressed, can and will do much more that mere superficial courtesy to cement closer bonds of mutual understanding between our peoples.

The truth of the matter seems to be that the strong individualism inherent in the Anglo-Saxon spirit has always made family rows not only a frequent occurrence, but even a favourite form of diversion. There seems little reason why today we should be so thin-skinned and supersensitive as to bewail this fact. Family quarrels, I am persuaded, are a potential source of much good in the world still, provided that they stop short of breaking up the crockery. An American author many years ago wrote a book entitled "The Autocrat of the Breakfast Table," yet it still remains for some serious scientific student of society to make a thorough study of the value to civilization of the ordinary family quarrels over the dinner table.

English criticism of America, however much it may irritate us at times, has nevertheless frequently kept us from becoming too vain-glorious, and has roused us to cure genuine defects in our habits and customs. On the other hand, the evidence of the British press would seem to indicate plainly enough that, on occasions, American criticisms of your ways, by the very reason that they are apt to rankle a bit with you, have been serviceable in persuading you to make needed improvements here. All this, I feel, is very much as it should be. It is a well-known fact that it is the only child, who is spared the give and take of family life, who is apt to grow up conceited and selfish. The present day family of English-speaking nations is entirely too large and too outspoken for any of us, through a lack of apt criticism, to harbour delusions of grandeur. In the rapidly changing world in which we are living, mere national vanity or mere national pride of opinion are not ends in themselves. Well-intentioned mutual criticism does not imply a lack of respect, but rather a genuine interest. It is some-

thing, after all, to care enough about another country to wish to improve it. We can all learn much from each other, even though the instruction is sometimes conveyed to us at the expense of our own self-esteem.

In the future, our established habit of freely criticizing each other is destined to be profoundly influenced by those great forces which are today drawing our peoples closer together in their economic attitude towards the rest of the world. Let me hasten to assure you that I have no intention today of inflicting upon you a heavy dissertation on political economy—so aptly termed "the dismal science." But it is worth pointing out briefly that, after a century during which England was always the creditor of the United States, today both countries are creditors in respect to the other nations of the World, and at the same time are both creditors and debtors in respect to each other. I confess I am uncertain as to how many of the Pilgrims are bankers, although nowadays one finds bankers almost everywhere. At any rate, bankers or not, I imagine many of you will agree with me when I say that it is something more than human for a debtor to love his creditor. We all recognize that in practice the surest way to gain anyone's deadly enmity is to lend him money. This fact was potent in promoting ill feeling between England and America almost throughout the nineteenth century. Today, however, we both are holding each other's securities and clipping each other's coupons, and this situation is in consequence a great gain as far as our future esteem for each other is concerned. On the other hand, both England and America are constantly lending funds to other nations and by virtue of this fact bid fair to become—if indeed we have not done so already—the most generally disliked nations in the World. Without commenting upon the possible consequences of such a development as between debtors and creditors, it at least seems apparent that the United Kingdom

and the United States have here a very real community of interest which never existed before, and that we can scarcely permit minor and trivial differences of opinion between us to cloud our vision in respect to it.

Not only in this, but also in another matter, do the present day Pilgrims possess a distinct advantage over their forbears in the task of improving Anglo-American relations. I refer to the epochal improvements which are being made before our very eyes in the vital means of international communication and transportation. It has already become commonplace for us in America to listen by radio to the oratory of your statesmen and the notes of your famous regimental bands, while as I remarked the other day, for better or worse American jazz bands have similarly invaded the British fireside. Over the vast grey expanse of Atlantic waters, which it took the original Pilgrims so many weary weeks to transverse, we can now converse easily by telephone. Not to be outdone, the modern masters of transportation are now promising us almost equally radical and striking improvements both by water and by air. We may yet live to witness the rise of the trans-Atlantic weekend. Travel has long since ceased to be the solace or necessity of the few, and has become the custom of many. Here again is a modern force constantly making for wider understanding of other peoples. Mutual tolerance and goodwill between our countries is consequently no delicate plant which any breath of frost can wilt, but an increasingly hardy shrub which can not only withstand but even benefit by occasional blasts of trans-Atlantic criticism. Our modern inheritance of the original Pilgrims' resolute and stoic spirit should enable us both, to forgive each other much of our oratory, and even some of our orchestras.

There seems little doubt, however, that the sudden shock of thus bringing together two quite different

societies, and in thus suddenly breaking down the barriers of their former privacy, is bound at first to produce a certain amount of confusion. One particular danger to the cause of deeper Anglo-American understanding lurks in the common belief that we both speak the same language. This notion is all the more insidious for being a half-truth. Frequently in America a very different meaning is attached to a word or phrase which is commonly used here in England in another sense. When, for example, an American banker speaks of "Corporation Stock" he refers to the shares in a company and not at all to the obligations of a Municipal Government—which is the phrase's accepted meaning here. The subtle pitfalls to Anglo-American business which such double-edged words provide are many. Some day we may both be able to provide ourselves with one of those useful little vest-pocket volumes which convert English into French or German, or vice versa, only this time devoted to translating English as it is written and spoken in Great Britain into the American dialect, and similarly American back into English. In the meantime, we will both have to be thoroughly on our guard, when we are talking with each other, to be sure that we are really talking about just the same things.

IV

A final community of interest between England and America today lies in the swift and constant changes which are being wrought in both our countries by the progress of invention. The apparently endless discoveries of science are almost daily overturning old and cherished modes and practices of living. The apparent limitations of the World of Nature are being almost daily circumvented or conquered. This dynamic development in the material and economic circumstances of life is in some respects even more clearly apparent here than in a younger country

like America, because of the sharper contrasts which modern inventions and habits present against your more ancient and settled national background. It is, for example, no anachronism to watch a motor car pass by the Woolworth Building in New York—both building and vehicle are essentially products of this modern age. But to watch a similar motor car before Westminster Abbey forcibly impresses the beholder with the fact that these scientific and mechanical developments of the last ten decades have taken the whole world for their sphere.

Just where all this astonishing change, which scientific invention is everywhere compelling, is destined ultimately to land us, is a matter for philosophers to decide. Indeed, it may be that we are in error in terming it "progress," although with this view I cannot myself sympathize. But none of us can escape the realization that because of this the world is entering a new era, whose ideals and standards as well as whose habits and modes of life are still scarcely familiar to us. Thus, launched forth on strange and unknown seas, we are all of us in a sense Pilgrims today, with new lands still to discover, new forests to clear, new fields to plough, and new temples to build. Even the character of the obstacles still before us cannot as yet be certainly foretold. And in the doubtful days ahead, we all have a profound need of the spirit and temper of the Pilgrim Fathers themselves. We may flatter ourselves that we have rid ourselves of some of their defects—of their narrower vision, their more bitter intolerance, their lack of grace and humour. But let us hope that in the coming years we have not at the same time lost the old Pilgrim virtues—a steadfastness in all weathers, a passion for the freedom and integrity of the human spirit, and a courage at all hours to strive, to find, and not to yield.

OUR INTERNATIONAL FINANCIAL MARKET

Address before the New York Board of Trade and Transportation, New York City, May 9, 1928

OUR INTERNATIONAL FINANCIAL MARKET

I very deeply appreciate the privilege of addressing this meeting of the New York Board of Trade and Transportation today. It might seem somewhat out of keeping with the ordinary pre-occupations of this organization, for me to talk to you about the international financial problems with which in the New York Stock Exchange we happen to be thrust into particular contact. Nevertheless, finance today serves every kind of business, and depends vitally upon business as a whole. The problems of American finance, as they continue to develop, are in consequence the problems of all American business. Moreover, in these days of rapid change and increasing specialization, it is particularly necessary for us all to familiarize ourselves with developments in branches of human effort other than our own, in order to avoid those misunderstandings within American business which are so harmful to our internal progress and prosperity. This must be my excuse, then, for discussing here in some detail the remarkable economic transformation of the United States into an international financial creditor nation, and for outlining to you some of the principal problems which this development has already created in the New York Stock Exchange.

II

Even before the war the United States had already created for itself a pre-eminent position among the nations of the world in agriculture, in commerce and in manufacturing. But the very magnitude and rapidity of this development had continually compelled the borrowing of capital from abroad. Thus the United States before the war was, in respect to

its international financial status, the greatest debtor nation in the world—a situation which proved a constant liability to the whole country, and on certain critical occasions an ever-present handicap to the freedom of its progress.

Through the nineteenth century, it is true, a very extensive financial system had grown up in this country, with its center in this city. Yet this development had occurred always under conditions when capital was more difficult to secure than good investments in which to place it. In consequence, both our financial psychology and traditions, and our financial machinery itself, have always been, and largely still are, those of a debtor nation. Formerly the New York Stock Exchange, while a very active and extensive market, was at the same time limited in its scope to the securities of this country alone, and was not an international capital market as it is today. Instead, our American securities before the war were dealt in not only in New York, but likewise in London, Amsterdam, Paris, Berlin and many other leading European financial centers. In those days, the first question which the New York stock broker was asked when he came to his office in the morning, was concerning the prices for American securities which had just been made in London. While the primary market for American securities was as a rule here rather than abroad, at certain periods foreign markets could place an independent price upon them, and at almost all times greatly influenced the making of their prices even in New York.

It has only been in comparatively recent years that these conditions, prevalent throughout the nineteenth century, ceased to exist, and the United States became the principal source of international capital in the world. The elevation of New York to the position which it today occupies as the world's leading financial center has been sudden indeed,

although this change has really been the outcome of a long evolution. In thus assuming the status of an international lending nation, the capstone of financial primacy has been added to our national leadership in agriculture, commerce and industry. It is highly important for us all, I feel, that this present financial position of the United States should be more adequately understood in America, and should be considered by present-day Americans not so much in mere complacency as in a critical and inquiring spirit.

III

An English writer once remarked that it was the oldest tradition in America that this was an absolutely new country. It is I think a mistake to consider the astonishing development of the New York financial market simply as the result of a modern economic miracle. Financial centers of importance do not rise through sheer accident in this way. It is therefore worth while reviewing hastily the long evolution through which the New York center passed before its present eminent position could be attained.

Early in the history of this republic it was still an open question whether New York, or the rival centers of Philadelphia, Boston or Baltimore, would become the leading commercial and financial city of the new nation. At the very outset, indeed, Philadelphia possessed a larger population than New York, and could more truly be said to be the real business and financial center of the country. But the construction of the Erie Canal in 1825, and the subsequent construction of trunk line railways between New York and strategic localities in the great Mississippi valley, rendered this city the readiest gateway to the North American continent. Thus it was transportation to which New York's subsequent commercial leadership among American cities can be primarily attributed.

Just as elsewhere in the world, financial developments have followed the principal thoroughfares laid down by commerce, so it was New York's early commercial leadership which compelled the establishment here of the leading financial market of the country.

It is also well to realize that, prior to the recent period when New York became a leading international financial center, it had been trained in a varied and strenuous experience in domestic affairs. Financial institutions of New York, indeed, have been developed under the most rapidly changing and frequently the most trying circumstances. Our financial markets have in their day been forced to contend with both foreign and civil wars, with booms and panics, with acute periods of depression and extreme prosperity, and with many varieties of unsound and uneconomic currency conditions. After this tempestuous youth, Wall Street is today settling down into an experienced maturity, all the sounder because of these past vicissitudes. The coming of the war in 1914, therefore, found here in New York a Stock Exchange organization schooled in adversity as well as success, and possessing a sound and thorough technique in most of the elements of this business. In addition, the provident creation at that time of our Federal Reserve system gave assurance for the first time in our national history, of adequate leadership in the field of short term credits and banking.

IV

Every business man I am sure is familiar to a greater or lesser extent, with the magnificent and constructive accomplishments in this sphere which stand to the credit of our Federal Reserve system. The Stock Exchange, however, is concerned with long term credits in the form of government and corporate securities, and it is this aspect of our financial markets to which I shall confine my subsequent remarks.

The first indication that an extensive market for foreign securities might develop here was really afforded in 1915 by the flotation of the $500,000,000 Anglo-French 5% Loan. Despite the magnitude of subsequent flotations in Wall Street, this huge undertaking still is a record for size. Very soon after 1915, however, America's entry into the war sharply interrupted foreign government financing in Wall Street. The United States Treasury undertook the flotation of United States Government loans to finance our associates in the war, thus making Treasury operations of what otherwise would have been individual and competitive loan flotations here. After the Armistice however, foreign government dollar loan flotations began in New York, first to the allied governments, then to neutral governments, and finally to even our recent foes in the war. This last development marked rather definitely the passing of war psychology in this country, and the advent of an era of constructive business and economic development.

The magnitude of foreign government financing which has been effected through the Wall Street market in recent years, has many times been pointed out in the press. Not even yet, however, do many Americans realize what a constructive force this has proved to the prosperity of this country no less than to that of foreign nations. At a time when civilization in central Europe was visibly crumbling, when the populations were reduced through economic collapse to the most primitive methods of barter and were almost universally threatened by disease and starvation, foreign government loans by American bankers successfully stemmed the tide of an impending disaster to civilization impossible to parallel in history.

Too often, however, were these very beneficial financial transactions considered as a species of charity. Actually they represented transactions which benefited the American lenders no less than the European borrowers. Without this extensive foreign financing

accomplished since the Armistice through the Wall Street markets, American exports abroad could not possibly have been maintained at the high levels which we have actually witnessed. An examination of American exports during these years should be sufficient to convince anyone that the American farmer and the American manufacturer, no less than American finance, have been vastly benefited by American loans to foreign nations.

The New York Stock Exchange in many cases has assisted in the distribution of these foreign government loans by providing a ready market for their instant purchase and sale. In 1925 the New York Stock Exchange set up definite listing requirements for foreign government bonds. Through this action, much information concerning foreign government finance has been made available for the first time to American investors, and at least a promising beginning has been made in the task of educating our investing public in foreign investments—a process which must inevitably accompany our national progress as a financial creditor nation.

V

As far as the experience of the New York Stock Exchange is concerned, a second stage in the development of New York as an international securities market was reached only last year in 1927. At that time the question arose concerning the possibility of introducing the shares of foreign companies on the New York Stock Exchange list. There was considerable financial opinion to the effect that, just as American shares before the war had been extensively dealt in upon the European stock exchanges, so now European company shares should similarly find a regular market on the New York Stock Exchange.

It is not strictly accurate to say that the New York Stock Exchange had never had any experience with dealing in foreign shares. Some foreign companies

had already issued shares in the ordinary American registered form, and these had been admitted freely to our market. In a few cases also, American certificates of deposit for foreign internal shares had likewise been listed on the Exchange. Undoubtedly, the simplest way for such dealings in foreign internal shares to occur in New York, would be the admission here of the same stock certificates which are dealt in abroad. Such a step, however, would create a host of difficult and unfamiliar technical problems. The New York Stock Exchange has developed for American share issues what is undoubtedly the most complete and most searching code of listing requirements in the world. Apart from this traditional policy of endeavoring through severe listing requirements to protect the American security buying public in all possible ways, the New York Stock Exchange could scarcely afford to be more lenient in listing foreign shares than in listing those of our own American companies. The Stock Exchange therefore sent abroad a technical commission to study this whole question. After visiting London, Paris, Amsterdam, Berlin, Brussels, Milan, Rome and Vienna, the members of this commission of inquiry made a complete report to the Stock Exchange which later served as a basis for the code of listing requirements for foreign shares which the Exchange officially adopted last fall. These listing requirements provide that American certificates of deposit, rather than the original foreign share certificates themselves, can be dealt in upon this Exchange.

While thus far only a few foreign share issues have actually been listed upon the New York Stock Exchange in accordance with these new and special requirements, the Stock Exchange has in advance familiarized itself with the technical problems involved in the work, and has established with conscientious care listing requirements designed to protect the American investing public in such securities.

VI

The most recent step in the expansion of the market for foreign securities on the New York Stock Exchange has been the listing of two British government internal loans—the 4% Funding Loan and the 5% War Loan. Together these issues amount to approximately $12,000,000,000, and constitute about one third of the entire British national debt. The 5% War Loan issue, amounting to about $10,000,000,000, is not only the largest foreign issue ever listed on the New York Stock Exchange but the largest issue of any kind whatsoever. The listing of these British government loans in New York has been hailed in London as a definite landmark in the development of this market. It is yet too early to comment with certainty on the practical results of this step. It may be useful at this time, however, to state a few of the reasons which led the Stock Exchange to list these bonds, as it did, upon its own initiative.

The claim has recently been made by many economists that the supply of capital seeking investment in this country was distinctly in excess of the amount of securities available for such investment. If this view is correct, it would seem that the addition to the Stock Exchange List of $12,000,000,000 of high class investment securities from abroad might fill a distinct economic need. While it is not the function of the New York Stock Exchange to direct capital into specific investments, at the same time it is important for the Exchange to provide all possible facilities here for the ready investment of American funds.

In the second place, it is possible that the readier availability of British internal government securities may prove useful in facilitating the continued retirement of the United States debt. Thus far our national Treasury has accomplished the extraordinary feat of retiring $1,000,000,000 of our national debt each year. The beneficial effects of the Treasury's work have

been widely felt. It is of course as desirable for a government to get out of debt, as for an individual citizen. But when the public debt is rapidly retired, it has the effect of making considerable amounts of capital available for investment in other securities. This is of course in general a great assistance to business. Yet it is undoubtedly undesirable for large amounts of surplus capital from this or any other source to pile up, without an adequate outlet into other useful forms of investment. Thus, from the standpoint of rapidly retiring our national debt—a step which all conservative economists and financiers heartily favor—it should be clearly beneficial to have extensive outlets for our surplus capital available through the leading security markets of the country.

There is another aspect of America's extensive present day foreign investment, and particularly our investment in sound foreign internal securities like the British government sterling bonds, which might be mentioned at this point. It is a well known fact that our national trade balances during recent years have been balanced not so much by wholesale exports and imports of gold, as by the large-scale import here of foreign securities. In proportion as America assumes the function of a creditor nation, this dependence on international security dealings to settle our foreign trade balances is likely to continue. A possible future outcome of the recent listing of British internal government bonds here may prove the practical creation of a convenient vehicle for settling international trade balances without shipping gold or unduly disturbing short-term money rates. Such a development, of course, would be of more immediate practical significance to nations whose gold holdings are relatively small, than to the United States where the real problem is to reduce surplus gold holdings. But as a creditor nation, it is useful for the United States to have all possible facilities for handling problems of this sort, and in the course of time our dealings in

foreign internal securities may assume genuine importance in this regard.

There is a final aspect of this tendency in America to make foreign investments which I should also mention. As superior methods of communication and transportation are being perfected, the nations of the world are being drawn closer and closer together. This highly significant modern tendency is having its effect in finance and investment, no less than in trade and commerce. In future years, I believe there will develop an increasing tendency for the leading modern nations to invest in each others' securities. Counterbalancing our recent extensive foreign investments in this country, there have also been extensive purchases of American securities by European countries. This international interchange of security investments is likely to prove a highly significant factor in the economic history of the future. For one thing, it should stabilize investment conditions all over the world—a development of particular importance to a creditor nation like America. In addition, such a universal exchange of securities between the nations should prove a most potent influence for peace, and for increased mutual understanding and cooperation everywhere. In this work the New York Stock Exchange promises to play a useful part by lending ready negotiability to the principal foreign security holdings of American investors.

VII

I have often been asked as to the future of New York as a financial center. Fully recognizing the great danger of attempting prophecies in this regard, I wish to state only a few of the fundamental principles on which the future development of this city as an international investment market must depend.

We should, in the first place, anticipate a steady growth in the business of finance and investment.

Not only are the amounts of capital available for investment increasing practically all over the world each year, but also new needs and outlets for the investment of capital are constantly being created almost everywhere. Economic developments as great as these are not of course due primarily to the Stock Exchange, whose expansion is an effect rather than a cause of them. But in order that the business may be adequately handled, it is highly important that the New York Stock Exchange should continually develop suitable methods of operation. In part, I have already outlined the recent progress which the Stock Exchange has made in this regard. It is gratifying for us to realize that to a greater extent than ever before, the facilities of the Exchange are being employed by American investors all over the United States, and that this market is being sought by securities originating in almost all parts of the world.

In coming years it is likely that the relation between the New York Stock Exchange and the other similar institutions of this and foreign countries will become closer and more intimate. Already there has been manifested a very striking growth in the twenty-odd American stock exchanges outside of New York, and by means of these helpful interior security markets, the business of security investment in this country is likely to be greatly stabilized and facilitated as time goes on. Somewhat the same thing may be said of the older security exchanges of Europe, where improving conditions have already resulted in a greater stability in respect to security markets.

We in New York must clearly realize that the New York financial market has been built up by no artificial monopoly, or other system of favoritism. Its growth has been due partly to the favorable trend of economic development, and partly to the vision and energy of Wall Street itself. In the present leading position of the New York financial market, we should feel pride rather than conceit or com-

placency. As long as the New York financial market can serve the public better than the markets of competing centers, so long will the present preeminence of New York as a financial center endure. Too many times in the world's history has financial leadership passed from one center to another, to make predictions certain as to the continued financial preeminence of New York. We cannot afford ever to overlook the all-important factor of service to the public. Based upon this eternal prerequisite of all financial markets, and indeed of all species of business, New York can confidently face a future promising indeed in its prospects for continued growth, and ever improving standards of commercial honor and integrity.

SAFEGUARDING THE NATION'S CAPITAL

Address before the Thirty-fourth Annual Convention of the Wisconsin Bankers Association, at Milwaukee, Wis., June 27, 1928

SAFEGUARDING THE NATION'S CAPITAL

I appreciate very much the privilege of your invitation to appear before your Association here today, and it is with genuine pleasure that I respond to it. This is not the first time that I have been the guest of the bankers and business men of Milwaukee, and I assure you I trust that it will not be the last. So rapidly is capital accumulating in this wonderful central district of the Great Lakes basin and the Mississippi Valley, that there is a constantly growing community of interest between investors and financial institutions here and in New York. Not the least important economic problem of our own times is therefore the question of safeguarding the capital of the nation. It goes without saying that this is a large subject, if one defines capital in the broadest terms, as any form of accumulated wealth whatever. On my part, however, I only wish to speak of capital as represented by liquid and negotiable securities in the form of bonds or shares. Inasmuch as the securities listed today on the New York Stock Exchange possess an aggregate market value of approximately one hundred billion dollars, the question of safeguarding capital only in the form of securities is a sufficiently great and complicated topic.

II

The tremendous increase of the American security investing public during recent years has been very generally recognized. The day was when a bondholder was popularly considered to be a quite unusual and exceptional sort of person because of the relatively limited class of Americans who regularly purchased or held bonds. But this condition of affairs

was ended, I trust forever, by the popularization of security investments during the great Liberty Loan campaigns and the subsequent period of prosperity. America is therefore in a fair way to become the greatest security investing nation in the world, and this very important development in our economic and social life is already having its effects practically throughout the whole world of American business and American finance. One such effect is to increase the interest and knowledge which American investors everywhere have for the leading American security market on the New York Stock Exchange. As long as this market possessed little practical contact with the average man, it was apt to excite a peculiar suspicion. But in a day like the present, when thousands of people are frequently employing the services of the New York securities market, much of the lack of understanding concerning it which formerly prevailed, has already vanished. On its part, the New York Stock Exchange has made unusual efforts to spread through the country a more general knowledge of its methods of organization and operation. These efforts have not consisted in endeavoring to sing its own praises on all possible occasions, but to make available all possible information concerning itself, and to invite criticism from all quarters, in the hope of improving and perfecting its services. The New York Stock Exchange has coupled this effort to make itself more genuinely understood with definite, and on occasions, drastic action designed to protect the security investing public on whose business the market basically depends. The New York Stock Exchange has not for many years, as a matter of fact, been a merely local institution. Ever since the adaptation of electricity to the practical tasks of speedy communication, the New York securities market has been a national institution in its services and in its scope of business. But in these days when in so

many directions and upon such a tremendous scale, capitalism has begun to share its benefits more widely than ever before throughout all parts of this country and with all classes of our population, its status as a national institution has of course grown in proportion.

Naturally, the more our security investing public grows, the larger becomes the task of endeavoring to safeguard the processes of security investing. Many separate agencies have today been enlisted in driving from the investment field the security swindlers who are always so anxious to prey upon it. Our Federal Post Office Department, for example, has been doing, often unnoticed, a magnificent work in excluding from the mails the insidious and fallacious advertisements of fraudulent security dealers. American business men themselves have been equally active, particularly in the creation of Better Business Bureau organizations in many of the leading American cities. These Better Business Bureaus, organized for the specific purpose of combating fraud directly and actively, have made a great record for themselves in purifying the national arteries of commerce and finance. But my mission to you here today is to tell you about some of the work along this very line which the New York Stock Exchange has undertaken in recent years, and its experiences with it.

III

Before undertaking to discuss the part which the New York Stock Exchange has striven to play in safeguarding public security investments, I should first perhaps explain briefly something concerning the powers and limitations of the Stock Exchange itself. There seems to be considerable confusion from time to time in the public mind on this score. While one set of critics may be denouncing the Stock Exchange for not taking action in some matter,

another group may at the same time be complaining of the Stock Exchange's "tyrannous and high handed actions".

The New York Stock Exchange is a voluntary association of 1,100 members, many of whom reside and have their places of business entirely outside of New York City. The purpose of this association, to paraphrase briefly its own Constitution, is to provide Exchange rooms and other facilities for the convenient transaction of their business by its members, to maintain high standards of commercial honor and integrity among its members, and to promote and inculcate just and equitable principles of trade and business. The Stock Exchange itself is not in business, and its operations are not undertaken for profit. Over a century of experience in conducting the affairs of the Exchange has led to the formulation of a considerable body of rules and regulations with which the business of Stock Exchange members must conform. But I would point out that the powers of the Exchange naturally apply only to its own membership, and not to the public at large. Over its own membership it is true the Exchange possesses very great and very complete power. It can discipline, suspend, or even expel members of the Exchange who in its judgment have broken the spirit as well as the letter of fair dealing. But the New York Stock Exchange does not possess, nor does it seek to possess, any official or governmental status. It therefore has no power over the public at large, and cannot reasonably be called upon to attempt to exercise any such power. Inasmuch as the basis of all the business of the New York Stock Exchange consists in the buying and selling of securities listed upon it by the American public, the interests of the Stock Exchange are bound to be identical with those of our investing public.

The safeguards which the New York Stock

Exchange endeavors to throw about the processes of public security investment are many and important. In the first place, it thoroughly investigates the records of candidates for Stock Exchange membership. Such candidates, in addition to being able to purchase a membership on the Exchange and to provide sufficient capital for engaging in the business, must be formally elected to membership by the Exchange's Committee on Admissions. Entirely apart from the amount of money any candidate may be able to command, he will not be elected a member of the New York Stock Exchange if his own business career has been tainted with unfair dealings in any form.

The same scrutiny is exerted in respect to the securities which can be bought and sold upon the Exchange. When application is made for the listing of any stock or bond there, the applying company or government must make a full and fair statement concerning the factors upon which the value of the securities depends. Naturally the Stock Exchange cannot attempt to play the prophet in regard to securities which it lists, nor does it officially guarantee its listings in any way. But it does see to it that adequate information concerning the securities is made available to the whole public which is thereby enabled to determine concerning the value of the securities with all the relevant facts at hand. In the long campaign for fuller and more frank corporate publicity, the New York Stock Exchange has consistently been a leader for the last fifty years.

An elaborate machinery in the Exchange has long been set up to enforce its regulations concerning fair dealings, not only between Exchange members, but also between any Exchange member and the general public. In addition, the Exchange carefully supervises the distribution of its ticker quotations, in order to prevent undesirable persons from employing Stock Exchange quotations to dupe and

swindle the nation's security buyers. Finally, in the field of fraudulent security selling, even though such activity lies entirely beyond the immediate scope of the Stock Exchange's business, the Exchange has nevertheless repeatedly called public attention to the dangers of the swindling evil, and has for several years been conducting a campaign to eliminate security swindling as a factor in our business life. Apart from cooperating on all possible occasions with our Federal government, the Security Commissions or Commissioners of our States, and local legal authorities throughout the country, the Stock Exchange was primarily responsible for the financing of the Better Business Bureau of New York, whose splendid work in combating security frauds has benefited not merely New York itself, but the entire country as well.

IV

One of the most controversial aspects of the New York stock market in recent months has consisted in the so-called brokers' loans. It is well known that these loans have increased very largely during the past year, and the fear has frequently been expressed that they were becoming entirely too large. The difficulty in discussing the size of brokers' loans consists in the lack of any dependable yardstick by which to measure them. Naturally, common sense would indicate that the more rapidly such loans grow, the more likelihood there is that they may soon become too large. But the size of brokers' loans is after all bound to be a relative question. It is a well-known fact that the United States has become the greatest financial creditor nation of the world. The immediate effect of this vastly important development has naturally been a very great expansion in the banking and security business recently. Just as unusual exports of American steel would greatly expand our steel industry, or unusually

large exports of grain would greatly expand our agricultural industry, so the recent enormous exports of American capital have necessitated a huge expansion in this country throughout the banking and security business. We have been seeing an unparalleled volume of new security issues created and offered to our investing public in recent years, and likewise unparalleled amounts of American capital constantly invading our security markets seeking investment. The whole scale of the security business in this country has in consequence experienced an enormous expansion in practically all its branches. Brokers' loans have thus risen along with turnover on all the stock exchanges in America, and the new security offerings made in every financial center of the country. The fact that this movement has continued year after year should clearly distinguish the period which we have recently seen, from the old-fashioned short-lived bull market in securities. As long as further American capital continues to be generated in this country, and continues to seek security investment in our market, I do not for one see anything fundamentally unsound in the increasing size of American financial statistics, nor in the growth of the ordinary financial facilities which America, as a creditor nation, should obviously possess to be able permanently to handle the business.

It is of course a very great fallacy to think that brokers' loans are purely unproductive, and are made only to finance speculation. Such a view, common though it may be, is most superficial and short-sighted. It is a well-known fact that most new securities are at first difficult to sell to outright investors, because they are not seasoned. It therefore becomes necessary in practice to hold a part of many new security issues in the market floating supply, until longer experience can induce security investors to put their money in the issues. Brokers'

loans in consequence represent just this floating supply of securities for the whole New York market. The collateral to these loans are securities in the process of distribution. To argue that brokers' loans are unnecessary or are unproductive, therefore, amounts to arguing that the whole security business of the country is unproductive. Actually America has been very wise in creating facilities for the ready financing of large and unseasoned security issues. We talk today of American industrial prosperity being based on mass production. We also realize that mass production demands tremendous initial outlays of capital and large corporate units, but we sometimes fail to remember that financing all this makes large loans on security collateral inevitable. To wipe out brokers' loans, or violently and arbitrarily to reduce them, would thus inevitably slow up American industry itself, if not fatally to halt its continued progress.

I would also mention, in connection with this subject of brokers' loans, a peculiar internal development in American finance during recent years which has tended considerably to increase them. I refer to the present-day tendency of American companies to obtain their working capital from securities and the security loan market rather than from commercial loans at the banks. The recent wealth of funds available in this country for security investment, and perhaps the memory of difficulties experienced with commercial loans during the financial contraction of 1920-1921, have induced many American companies to sell new bond and stock issues, accumulate large cash surpluses, and thus render unnecessary borrowing at the banks on open account or with commercial paper. When such cash surpluses are not employed in their business, the companies will lend them in the call loan market. Undoubtedly this is one reason why commercial loans have not in recent years expanded to the same

extent that loans on securities have. Novel as this method of corporate financing really is in this country on its present scale, it is yet too early to assert that it is less safe and sound than former methods were. But it has imposed on brokers' loans the task of financing not only the fixed capital needs, but also the working capital needs, of innumerable American business corporations.

A final consideration lies in the fact that brokers' loans in practice act as a sort of buffer to commercial loans. When credit deflation becomes necessary, it is always brokers' loans that are deflated first. Thus these loans represent a surplus which can be employed for other purposes, should the occasion arise. The events of 1919-1921 clearly showed the truth of this assertion. The peak of the call loan market was reached in November 1919, after which these loans were rapidly deflated. By the late fall of 1920, over half a billion dollars had been squeezed out of brokers' loans, but meanwhile the total volume of loans by all American banks had risen very greatly, thus indicating that the credit obtained by deflating brokers' loans in Wall Street was being used to lend to farmers, merchants and manufacturers all over the United States. Furthermore, after 1921 many corporations were enabled to retire frozen commercial loans at their banks by floating new company securities in Wall Street. But these new security flotations, being unseasoned, had to depend on the market for brokers' loans in large measure to carry them until they could be distributed to permanent security investors. In this way, the security collateral loan market in Wall Street represents a surplus market which in the past has shown its ability to act as a buffer for commercial loans in times of deflation and in particular instances to liquefy frozen commercial loans. Our brokers' loan account today is large mainly because our surplus of capital in America is large.

We should have, I feel, few fears that our banking authorities will allow brokers' loans to absorb an undue amount of the credit of our national banking establishments.

V

No discussion of the securities market can be accurate or complete without clearly distinguishing between capital and credit. I do not wish to enter into the labyrinth of difficult economic questions to which the scientific establishment of such definitions inevitably leads. As working definitions, we may say that credit is a kind of temporary and conditional capital. The brokers' loans which have been so much discussed recently are really for the most part extensions of credit by lending financial institutions. I do not need to remind this audience of bankers that sometimes a financial institution can lend too much credit and thereby get itself into an embarrassing position. For this reason, we are all bound to feel a certain apprehension concerning any business at all which is carried on largely with the use of bank credit. Just as new extensions of credit may foster an expansion in business, so a contraction of credit may curtail business. If this were the whole truth concerning the stock market today, or for that matter at any other active period of its history, the question of brokers' loans might well assume a quite alarming aspect. But we must not look at the stock market solely and merely from an angle of credit, for the question of capital even more fundamentally influences its constant development and expansion. I have already alluded to the fact that the general wave of commercial and industrial prosperity in this country has led to the accumulation of unprecedented amounts of capital. This capital may be destroyed through unwisdom or waste, but it is not subject to expansion or contraction on the same basis that

bank credit is, and it has been the continual stream of this fresh American capital into our securities markets that has been fundamentally responsible not only for their expansion in scope, but also for the enhancement in the prices of their securities. Investors from all over the country, both large and small, have been continually purchasing securities outright and locking them up in their strong boxes for permanent investment. Large outright purchasing of American securities for long-term holders has also come into the New York market from the recently rehabilitated investing classes of European countries. So important has this factor proved itself in recent years that, as I see it, the major concern of the Stock Exchange today really lies in the question of how far its facilities are adequate in handling this continual flow of investment funds. The question of credit, as far as the Stock Exchange is concerned, is one for the banking institutions which are experienced managers of credit problems.

If we are to obtain a clear notion of how this factor of surplus capital has been affecting our security markets recently, we must for purposes of contrast consider a moment the very different conditions in this respect which existed in this country practically from its foundation down until quite recent times. For over a century, the United States was, with scarcely an important interruption, always a debtor country. We were larger consumers of capital than producers of it. The upbuilding of the United States, including the construction of our enormous railway systems and our huge industrial facilities, consistently called for more capital than the American people were able to save. For this reason, in the Wall Street securities markets, down until a few years ago, securities were always more abundant than capital, and in fact the foreign stock exchanges of London, Amsterdam and other European centers had been largely depended upon

for the ready marketing of American stocks and bonds.

In recent years this situation has been suddenly reversed, and we have found ourselves in the possession of sufficient capital not only to finance all our own business undertakings, but also to make large foreign investments. This new situation is still only imperfectly realized and understood, even by our financial leaders. We still have the psychology of a debtor country, and the experiences of a century have tended to make our financial machinery and financial facilities essentially those of a debtor nation. Thus it comes about that our current surplus of capital has proved both mystifying and embarrassing to us. But it may well be that we must accustom ourselves, because of our new creditor status, to a situation where capital is more abundant than good investments. Indeed, the constantly falling yield of the best American investment securities would seem to indicate that such a situation is already at hand.

So unusual is this abundance of capital in this country, that we have not all as yet realized on the one hand the great potentialities for good which it conveys, and on the other hand the peculiar dangers with which it is attended. From the borrowers' standpoint it might seem that cheap capital was unquestionably a good thing, and undoubtedly an abundance of capital is one of the greatest stimulants to industrial production and commercial distribution. But this is by no means the whole story. Literally millions of people in this country are investors, and by reason of steady investments during their active years of life, they are striving to create for themselves a competence in old age. This practice of small-scale thrift is of enormous social and economic importance, and any interference with it is highly undesirable. Naturally it is much easier for the small investor to accumulate a competence

for himself when the yields on standard securities are high than it is when these yields are low. If the yields on conservatively invested capital, through the accumulation of a national surplus of capital, become unusually low over a long period, it will operate profoundly to discourage private thrift and investment. For this reason cheap capital, as I say, is not an unmixed blessing, and what we really need today is stability of security yields at reasonable levels.

It was the realization of this obvious and yet frequently overlooked fact that led the New York Stock Exchange this spring to list the two great British government sterling bond issues, which together aggregate in their outstanding amounts approximately twelve billion dollars. By this step these securities, which are generally thought to be the best foreign securities in existence, have been placed at the ready disposal of investors all over the United States through the market on the New York Stock Exchange. It was felt that thereby a genuine service was being performed for the American investor, and at the same time a new stabilizing factor was being introduced into international commerce and finance. For today it is a well-known fact that trade balances between nations are being settled to a greater extent by the purchase and sale of securities than by gold shipments or shiftings of short-term credit. More and more we are approaching the time when the yields on long-term investments will rise and fall together all over the world, and the introduction in our markets of British internal government bond issues should facilitate the readier stabilization of security prices and yields, not only inside the United States, but also between the United States and foreign countries.

VI

A final word of explanation is perhaps necessary in regard to the attitude of the Stock Exchange toward price movements in securities which are dealt in upon it. The Stock Exchange makes every effort to establish and maintain free and open markets for its listed securities—markets in which the power of public buying and selling is readily and immediately felt, and in which all purchasers and sellers are accorded the same even-handed justice. But it is obviously not the province of the Stock Exchange to concern itself with movements in security prices as such. Public opinion must in the long run be depended upon to regulate the levels at which security prices stand at any particular time, and the Stock Exchange fulfills all its proper functions by maintaining a market where the forces of supply and demand originating with the investing public can meet and mutually satisfy themselves.

After its century of experience in the business of maintaining the leading security market of this country, the New York Stock Exchange is firmly of the belief that unusual price movements in securities, or waves of security speculation, have a way of adjusting themselves without the intervention either of the Stock Exchange or other artificial regulation. This attitude toward price making and speculation in securities represents a faith in democracy and the common sense of the average man translated into financial terms. In the long run it has, throughout history, proved the basis of all the great markets of the world, whether in securities or commodities. There is all the less reason for apprehension in these matters today, because of the existence of the Federal Reserve system.

As for the Stock Exchange itself, while it properly restricts its functions within the scope of its abilities for practical performance, at the same time these

functions are sufficiently important and difficult to necessitate continual vigilance and continual effort on its part.

Under freedom the New York Stock Exchange has over the past century been able to foster and develop thrift and security investment not merely in its own locality but all over the United States. It provides not only those indispensable financial facilities for marketing securities which have been so widely availed of by American business and even by the American government itself, but also fundamental and time-tested safeguards in security dealings so vitally needed by the steadily increasing class of public security buyers throughout the nation.

THE STOCK EXCHANGE AND AMERICAN AGRICULTURE

Address before the Annual Convention of the Nebraska Bankers Association, at Omaha, Nebraska, October 17, 1928

THE STOCK EXCHANGE AND AMERICAN AGRICULTURE

It is, I can assure you, a very particular pleasure for me to be here today. As President of the New York Stock Exchange, I have always felt the national necessity of closer cooperation and wider understanding between the financial center in New York and the rising cities of the great American West, and have tried as far as possible to promote more intimate and sympathetic contacts between them. Before attempting to speak to you concerning the New York Stock Exchange, I wish to confess how much this Western trip has stimulated me. To anyone like myself, most of whose waking hours have for many years been spent in the deep canyons of the Wall Street district—that most congested section in the whole world—it is of course a sharp contrast to travel through the vast spaces of our Western states, and to visit a center like Omaha, whose future growth must inevitably be so great and so long continued. But, to the security dealer or the stockbroker, there is more to it even than that. To the Wall Street man, it is impossible to visualize the vast actual and potential wealth of the West without coming out here and seeing it. Yet just this Western wealth and the business energy and ability of these Western states, really underlie the paper security certificates which are daily bought and sold in such volume in Wall Street. It would, I feel, be a very desirable part of the young New York stockbroker's training, if, before undertaking his duties on the New York Stock Exchange, he could come out here and get a better knowledge of the great American business equities provided by the growing communities of this vast Western region,

which so largely underlie the leading issues of American railway, utility and industrial security issues. By the same token, it would be an equally desirable thing if more Western business men could come East oftener and visit the New York Stock Exchange, which, I venture to predict, they would discover to be a very different sort of institution from what writers of vivid imaginations but insufficient knowledge have sometimes reported it to be.

However, I have not come here to sing the praises of the Stock Exchange, but rather to discuss its relationship to American agriculture. So frequently has this relationship been misunderstood, in the East as well as in the West, that it seems to me particularly important to brush aside fables and mythology, and look at the thing for once from a realistic economic standpoint.

II

In the early days of the Western settlement, most of our security investors lived in the Atlantic States, and many of them lived in Europe. That situation is now ancient history. Security investment was placed on a nation-wide basis during the late war and the post-war periods. Not only have the individual citizens and the financial institutions of this leading Western center become stockholders and bondholders already, but inevitably as time goes on you will in turn inherit all the problems arising from security investment with which our older Eastern States have long struggled. More and more you will attempt to master not only the subject of securities, but also of the markets for these securities on the different stock exchanges. You will more and more experience the same need of free and open securities markets, reliable and current security quotations, and orderly and dependable brokerage service, that every other rising community in modern

history, whether in America or in Europe, has also experienced. Not only your own needs as investors but also the increasing financial requirements of your own local industries will very generally lead you to organize stock exchanges of your own in order more readily and more safely to facilitate and direct the flow of fresh capital into industry. Indeed, just this step has already been taken in many young but far-sighted Western cities. In the future, therefore, your economic destinies will more and more be influenced by security markets, so long as your remarkable commercial and industrial growth continues at the same pace that it has been going recently.

But the West's interest in stock exchanges is by no means a matter only for the future. There have been for many years many indirect yet profoundly important links between the New York Stock Exchange and the Western agricultural regions. One of these consisted in the rapid and continual building of railway lines through the West which has for many years occurred on an enormous scale in this part of the United States. In the hurry and turmoil of American life, we are all apt to forget the immense importance of railways to everyone. As a matter of fact, the establishment of the great railway systems of this country was an international event of major importance, as even Europe is now commencing to realize. For without the great rise in American exports of agricultural produce, the population of Europe could not have continued to increase as it did after 1870. Moreover, the railways opened up this whole vast central empire to settlement and civilization. It is even a subject of conjecture whether, without railways, the United States Government itself could have ever effectually placed this tremendous internal Mississippi River basin under one national rule and one national allegiance. It goes without saying that without dependable rail-

way service, the American farmer in the West would have remained isolated in this great interior region, without facilities either for shipping eastward his surplus production or readily obtaining from the East the tools and manufactured products, lacking which he would have inevitably sunk into a way of life little better than that possessed by the Russian peasant—a situation intolerable for the free citizens of a democratic government like our own.

Now it is frequently forgotten that American railway building for almost the past hundred years has been profoundly dependent upon the capital market on the New York Stock Exchange. It was largely by means of this central market for capital, that the funds of millions of investors were collected and put to work laying railroad ties, building railroad tunnels and bridges, and establishing the railroad juncture points here in the West which were later destined to grow into thriving and prosperous commercial and industrial cities. Indeed, this process still continues, and the facilities of the capital market on the New York Stock Exchange are still serving to attract capital as it is needed into improving our railway facilities in this country. Very obviously, the larger our railway systems become, the more adequate equipment they obtain, and the more adequately they are financed, the better is going to be the American farmer's outlet for his surplus production. Thus in our American railway systems, a very vital link has developed between American agriculture and Wall Street. I can assure you from my own experience that when the Western farmer cannot send a good crop to market over the rails, you will find a very unhappy stock market in Wall Street.

Sometimes when I remind Westerners in this way of the historic debt which their now thriving communities owe to Wall Street, they will admit the general truth of my assertions, but nevertheless declare that there should not be so much speculation

in the stock market where capital is being furnished for our enterprises. With this view I cannot agree. No one ever yet in the history of this world has developed a new country, or ever will, without speculation. The earliest white men to penetrate the West were speculators in furs, which they tried to buy cheap and sell dear like a speculative trader in stocks and bonds today. If speculative profit had not been possible in the fur dealings of the early pioneers who blazed the trails throughout the West, they would never have come out here to struggle not only with the difficulties of the fur business, but with the Indians and wild beasts of the forests as well. So, indeed, it was with the farmer who found that in your virgin and fertile soil he might raise cheap wheat and sell it at a speculative profit in the Eastern markets. Today, the American wheat farmer is compelled to speculate, not only on his own yield per acre, but on the climate, insect pests, and even the crop conditions in Canada, India and the Argentine. In the long run, almost everyone in this country speculates in something continually, and that is one reason why the United States is the dynamic, progressive nation it is. The Russian Soviets tried to create a government under which speculation would not be permitted, but today their representatives are coming to Wall Street to attempt the difficult task of discovering someone who may be persuaded to speculate in Russian securities. Sometimes financial speculation can be overdone, but I have never yet seen any other good thing in modern life which could not also be overdone. As economic conditions become stabilized, the danger of over-speculation rapidly dies out. But in new, uncertain and hazardous enterprises, speculation is always vitally needed as a principle of energy. Some day we may change our transportation methods in this country by taking to the air. Yet before air lines can be universally established in the United

States, large amounts of speculative capital are going to be required, and large speculative dealings in the securities of airplane manufacturers and operators will inevitably occur on the Stock Exchange.

In consequence, the American farmer has been greatly benefitted by speculative dealings in American railway stocks and bonds on the New York Stock Exchange. I appreciate that the farmer has had his differences with the railway managers as to freight rates, like most other shippers. With the merits of such controversies I am not familiar. But it is at least safe to assert that the American farmer has been vastly better off with even imperfect and over-expensive railway service, than he would have been had there been no railway service at all. And without the capital drawn from the capital markets on the New York Stock Exchange and its kindred institutions here and abroad, the American railway system of today could never have been built.

It is likewise significant to the American farmer that capital has been found through the New York Stock Exchange for securities other than those of American railways. Many of the goods and implements which the farmer receives from the cities in exchange for his surplus, are produced by means of funds gathered together through the speculative stock market. So it is with much of the improved agricultural machinery which the farmer employs, or his fertilizers, or his motor cars and trucks, or his electric or acetylene lighting systems, or his radios. Many of these things are necessities to the farmer, if his standard of living is to be maintained at equal levels with those existing in the cities. Moreover, they are necessities to him in the efficient and profitable prosecution of his own business. There is as much difference between the independent American farmer and the agricultural peasant in other countries, as there is between a steam loco-

motive and a two-wheeled horse and wagon. But one great reason why all these improved tools and utensils can be obtained and enjoyed by American agriculture, is due to the mass-production of American industry, which in turn could never have existed without the means provided by the Stock Exchange for collecting vast sums of money from all over the country, and sometimes from all over the world, for the oftentimes highly speculative investment in our new and large-scale industrial enterprises. On certain occasions, indeed, the work of the Stock Exchange in distributing foreign securities has placed funds in the hands of other countries which they have used to purchase American wheat, American cotton, and other American agricultural produce. It is therefore a very great error to get the notion that the New York financial center is somehow hostile to the American farmer, and desires only to impoverish him. Wall Street cannot benefit by a prostration of American agriculture which not only threatens its own food supply, but takes out of the market millions of actual or potential security buyers, and renders profitless a large proportion of our great American industrial undertakings. Although it is true that agricultural problems are not always clearly understood in New York, it must in the nature of things desire to see agricultural prosperity, if only to be assured of a better ability to sell its own goods and services. As a matter of fact, it was a former member of the New York Stock Exchange—Mr. Eugene Meyer,—who organized the War Finance Corporation which did such valiant service to American agriculture in the serious depression which swept this country eight years ago.

III

Another indirect but highly important service which the New York stock market has long rendered American agriculture lies in the banking field, in

the very call loans on securities concerning which there has recently been so much discussion. This whole subject of security loans in New York has frequently been misunderstood, and I therefore welcome this opportunity of calling your attention to certain phases of it.

The loan market on Stock Exchange securities was organized in Wall Street many years ago. Since at that time it was imperative that there should be available to bankers some form of short-term banking investment which would be both safe and liquid, the custom grew up to make these security loans on demand. This market in Wall Street for call or demand security loans has accordingly been developed over several generations, and has been surrounded with a wide variety of safeguards for the lenders. Today the New York call loan market is undoubtedly the most highly organized security loan market in the world. For many years there has never been a loss to a single lender arising from a call loan made to a Stock Exchange member and based on the collateral of Stock Exchange securities. Thus call loans are unparalleled in their safety to our lenders, for the same safety has not been seen even with government bonds. Banking funds that have flowed into call loans in New York, while often employed for very speculative purposes, have at the same time performed an enormous task in facilitating the issuance of new American securities with which our railway lines have been built, our mining shafts have been sunk, and our industries have been founded.

But, although there is much to be said on the economic usefulness of call loans, I wish to confine my remarks simply to the sometimes unsuspected benefits which American agriculture has derived from them. Oftentimes Western banks have been severely criticized for lending part of their funds in Wall Street on call. Local borrowers have not un

naturally asked why local deposits should be sent half way across the continent to lend in New York, as long as they could possibly be employed in their own locality. Such a practice, on the face of the matter, seems unfair to the local community, yet, as we all know, local bankers continue to engage in it. Let us see just why they do so.

An examination of interest rates in the agricultural districts and in New York over a period of years clearly shows that as a rule the rates of interest on stock market loans are considerably below the interest rates charged by the local Western banker on local loans. It can therefore scarcely be said that the local banker out here sends his money to lend in Wall Street, in order to obtain a higher rate of interest upon it. It is true that very recently call loan rates have been excessively high—even higher than interest rates for local loans. But over a period of years, it is apparent that the local banker would receive less interest in Wall Street on his money than he would right in his own community. There obviously can be no permanent advantage therefore, to the local banker in lending his money in Wall Street because of more favorable interest rates there.

Another important restraint on the local banker to keep his funds working in his own community lies in the nature of the banking business. In the United States, as we all realize, we have rarely allowed general or branch banking, on the theory that the independent local banker was a more potent force in building up his own community than a mere branch of some large Eastern bank possibly could be. In general, American bankers have always felt that this independent banking system of ours has justified itself by the amazing rate of growth in local communities seen all over the United States, and in this belief I too will concur. Now, if one is in the business of running a bank, one of the first things

that he desires to do is to see his deposits increase. If the local banker, by providing accommodation to local borrowers, can build them up from small depositors to large depositors, the growth of his bank is sound and inevitable. Therefore, the local banker has every selfish reason to lend his money locally. When he sends his funds to Wall Street to lend on call, he does not similarly assure himself of a steady growth in his own deposits. As a Stock Exchange broker, I might borrow funds coming into New York from many Western banks, yet practically always I would be completely unaware of which banks were lending the funds to me, since I would obtain the loan at some large New York lending institution. Under the circumstances, I could not assist the local banker in increasing his deposits year after year as a local borrower would. It therefore seems obvious that a local banker who lends money on call in Wall Street sacrifices to that extent his ability to follow the usual policy of growing up with his own community, which has always been the main secret of a successful commercial banking growth in this or any other country.

The local banker therefore does not lend money on call in Wall Street because of superior rates of interest there, or because of special advantages in building up his institution which he can thereby obtain. He makes these loans on call for an entirely different reason—that of preserving the liquidity and solvency of his own institution. Self-preservation is the first law of banking as well as of life, and all our banking experience in this country bears out this fundamental fact. The American banker who does business in a community mainly devoted to the production of one or two single major agricultural crops, faces difficulties with which the larger Eastern bankers do not to the same extent contend. Indeed, I think it may be stated that it is fundamentally a more difficult thing to run a small bank in the wheat belt,

or in the cotton belt, than it is to guide the destinies of a bank whose loans are diversified among many industries and undertakings. Five years ago there were nearly 30,000 separate banks in this country—today there are about 26,000. As we all know, this considerable decrease of from 3,000 to 4,000 banks in this country has mainly been due to banking insolvencies. There is little need for me to point out how serious a problem this high percentage of banking insolvencies constitutes to everyone. Perhaps there is no single event so universally harmful to a whole community as the insolvency of its banking institutions.

It is just in this connection that the services of the call loan market on securities in New York have proved so beneficial, particularly in the last few years. I again repeat my former statement that there is no record within the memory of Wall Street where any lender has lost a penny on call loans to Stock Exchange members on Stock Exchange securities. It is obviously true that if the many banks through the country which have in the past few years been forced to announce their insolvency, had placed a larger proportion of their funds in these call loans, they might not have been forced to suspend as they did. An extreme case of just this sort occurred during the disastrous Florida real estate boom, and was recently cited by an eminent American economist, testifying before a Congressional Committee in Washington. At the height of the real estate boom in Florida, a large national bank there held about 66 million dollars of deposits. But it only loaned eight millions locally and invested the remainder in Wall Street, either in U. S. Government securities, call loans or other safe and liquid forms of paper. When the crash came, this bank's deposits fell swiftly to 23 million dollars, during a terrific strain on local credit which forced many Southern financial institutions to suspend. But

because this bank had kept its funds in liquid form, it was able to pay out over 40 million dollars in cash to its depositors. I have no doubt that at the height of the boom, local borrowers in Florida criticized this bank for lending so much of its deposits in New York and so little locally. But when the crash came, this institution proved a tower of strength in the local community by allowing every depositor to withdraw his funds without question or delay.

Although, as I say, this is an exaggerated case, nevertheless the same sort of thing has occurred often before with local American banking. It is no service to the community for a local bank to lend all its resources there, and through subsequent illiquidity be forced into bankruptcy. I do not need to point out to you how harmful to American agriculture have been the numerous Western banking failures of recent years. And so the call loans of Wall Street, while they do divert a certain amount of money from possible local use, at the same time save a community from the terrible economic scourge of bank failures. Call loans have thus proved for many years of great indirect assistance to American agricultural banking. Local agricultural banks no doubt deserve criticism if they lend more funds in the call loan market than is required by the necessities of their own liquidity and solvency. But, as I have already pointed out, their desire for increasing their deposits and usually also the more favorable local rates of interest, can generally be depended upon to restrain them from such a course.

IV

The serious character of the American agricultural problem is today very generally recognized, not only in the agricultural districts themselves, but also in the large Eastern centers of population. We all must recognize that there can be no great or lasting

prosperity in this country if depression reigns on the farms. Both our foreign and our domestic trade are very profoundly bound up with our agricultural production and prosperity. History clearly shows that the nation which can no longer feed itself will inevitably suffer under a great industrial and financial handicap.

I must confess that I personally know very little about agriculture, and do not pretend to be able to offer any easy or ready panacea for our present agricultural situation. I only wish to leave one thought with you—that if closer relationships between our securities markets and American agriculture could be established, it might assist agriculture in very vital ways. I have already pointed out that stock exchanges, by reason of their ability to distribute securities among investors, have in the past been able to direct an almost constant flow of capital into American commercial and industrial companies. But the stock exchanges have not been to the same extent able to perform a similar function for agriculture, because of the fact that there are practically no such agricultural securities. As I have pointed out, the capital directed by the stock exchanges into certain industries whose products and services are extensively employed by farmers, have to that extent been able to perform a genuine even though indirect service to American agriculture. Yet American agriculture itself has rarely been organized in the form of large corporations like American industry, and in consequence little direct contact between the stock exchanges and agriculture has been possible.

I am far from feeling certain that I am making a suggestion here which is either practical, or perhaps particularly pleasing to the American farmer himself. For, as we all realize, our farmers have always proved intense individualists, and are likely to continue such. Nevertheless, the gradual development

of cooperative marketing in this country may sooner or later take the form of stock corporations, and if it does, the way lies open through our established stock exchanges to direct capital into agriculture just as in the past it has been directed into commerce and manufacturing. I have always felt myself that some form of share financing for agriculture, if it could be soundly devised, might in a financial way prove of real benefit. The farmer, as I see it, does not need new creditors, but rather new financial partners. In consequence, the farmer's financial salvation would seem rather to consist in the issuance of shares of some sort than in the continued issuance of mortgage and other bonds, under the burden of which he already suffers. The man who can invent a feasible way to enable our farmers as a class to obtain additional capital inexpensively from new share partners, will, in my opinion, have performed a most valued service for agriculture, by opening to agriculture an immediate access through the stock exchanges to the savings of the entire American people.

It is, of course, dangerous to press too far the analogy between agriculture and industry. Nevertheless, there is already evidence that certain methods which have proved very successful in industrial enterprises, might be adapted to serve agriculture also. One of the chief of these consists in the utilization of waste products. Our chemists are in this field making very rapid progress. Almost every month we see the announcement that chemists have succeeded in utilizing agricultural by-products as the raw material for making new and useful industrial materials. Already on the list of the Stock Exchange one can find a good many different companies which are extensively engaged in this business. I need not mention the remarkable utilization of the whole corn plant by the enterprising chemists and manufacturers of today. If some more

evident way can be devised for giving actual value to agricultural by-products which at the present time are completely valueless to the farmer, we will have taken another very fundamental step in stabilizing American agriculture and assisting in the cause of agricultural prosperity. I may add that there is very much more interest in financial circles in constructive and soundly undertaken enterprises of this sort than perhaps the farmer himself realizes, and the Stock Exchange is only one of the parts of our financial machinery which may in this regard be able in the future to perform a constructive task with great benefits to agricultural producers, as well as to American consumers everywhere.

V

I need not remind this audience that we are living in an age of rapid and momentous scientific discoveries. Science has taken the whole world for its domain. It has attacked the problem of transportation, not only to improve the already familiar inventions of the steam railway and the steam vessel, but also to launch high into the air those astonishing airplanes and dirigibles which already have begun to revolutionize travel on both the landways and the sea-ways. Scientific methods of manufacturing production have cheapened the cost of many products like the automobile, with the result of placing them within reach of everyone's purse. Scientific management of business enterprises has enabled our industrial companies to maintain unparalleled wage-scales, and still decrease per unit costs by quantity production.

But the scientific movement of the age must not halt within our cities, and limit itself to only industrial or commercial processes. It must go on, to achieve new triumphs on the farms of the nation.

With even my scanty knowledge of American agriculture, it is nevertheless apparent that just this scientific rationalization of agricultural work and agricultural life has already begun. Its further prosecution means not only wider spheres of usefulness for our industrial, utility and commercial enterprises, but also an increased productivity on our farms and a better and finer way of life throughout our vast agricultural regions. In the movement, the immediate need is of course for the practical farmer, the scientific engineer and chemist and the far-sighted corporation executive. American finance can only stand by to assist the practical accomplishments which their efforts will yield. Yet such assistance, already being rendered indirectly and partially, may still develop into a closer and more intimate partnership between American finance and American agriculture. In such a development, I can assure you that I speak for the New York Stock Exchange, when I say that, if a way to do it were discovered, its facilities would be placed as enthusiastically and completely at the service of American agriculture as they have already been at the service of American commerce and industry. In the continued effort to establish in this country a firmly founded and universal prosperity, we must not fail to place all our scientific knowledge, all our organizing ability and all our financial facilities behind that oldest and most basic of all our industries—American agricultural production.

THE FACTOR OF CREDIT IN AMERICAN BUSINESS

Address at the Annual Fall Banquet of The New York Credit Men's Association, New York City, November 13, 1928

THE FACTOR OF CREDIT IN AMERICAN BUSINESS

It is, I can assure you, a very real pleasure for me to be able to address you this evening. The securities market naturally has a very genuine interest in the problems in which you gentlemen specialize. In large measure, also, the New York Stock Exchange is, in its field, trying to bring about that increased safety and certainty in the employment of credit which, in the last analysis, is the aim of credit men also.

Today the extension of credit is practically an universal factor in all business. In some respects, indeed, credit may be termed the common denominator of modern business. The sensitive, yet powerful, effects of credit control may be seen throughout our entire business structure, whether as a stimulant for the expansion of business, or as a brake upon an expansion which has become dangerous and unsound. Because of this great importance of credit problems today, it is becoming more and more necessary that the analysis and judgment of credit be made expertly. The immediate aim of such work is, of course, to assure the safety and certainty of money lenders and others in extending credit, yet the methods of credit control which you gentlemen advocate and employ have also, in the aggregate, a most important effect upon our entire national economy. It has always seemed to me a most encouraging sign for the future that credit men are rapidly coming to constitute a new profession. Even more in the future than at present, one of the most important elements in all modern industry, commerce and finance is being committed to your hands, and much will depend upon the ability and initiative with which you will

continue to cope with the many difficult problems which this most important work of assaying and determining credit constantly raises.

II

As superior methods of handling and extending credit are attained, one important effect of this development is to standardize and render more impersonal the employment of credit. Credit work in its most primitive stages must deal with men rather than principles. But as the soundness of handling credit is developed, purely personal considerations in the employment of credit tend more and more to vanish, making the situation in regard to credit not only safer but more democratic. When the tendency of all trade to centralize is borne in mind, this is a reassuring thought.

In the New York Stock Exchange we have had in recent years an experience of just this sort. In 1922 the New York Stock Exchange inaugurated the practice of requiring its member firms who carried public accounts to submit to the Exchange at least twice a year, and oftener when and if demanded, a full statement of their financial condition. This was at the time considered both a radical and a drastic step, for no stock exchange had ever established any such system of centralized control before. This so-called "questionnaire system," however, has turned out to be a very great success, and today no one in the Stock Exchange would think of abandoning it. One striking result of the closer surveillance of the financial condition of Stock Exchange houses which the new plan has provided, has been the marked curtailment of suspensions of members of the Stock Exchange for insolvency. Prior to 1922, the percentage of Stock Exchange members suspended for insolvency ran each year higher than the similar percentage of our national banks, lower

than the percentage of American commercial firms, and roughly the same as the insolvency percentage of American banking institutions of all descriptions. Since 1922, however, insolvencies of New York Stock Exchange members have fallen to very low figures indeed, despite the continuing high levels of commercial insolvencies and the increases in banking insolvencies. In 1926 not a single member of the New York Stock Exchange was suspended for insolvency, and during 1927—the last calendar year—only one member of the Exchange was suspended for this cause. During 1927 the percentage rate of insolvencies for Stock Exchange members was about one-sixteenth that of all American banks, about one-fifteenth that of our national banks, and about one-twelfth that of American commercial firms. I mention this record, of which we in the Stock Exchange are naturally very proud, in order to illustrate the fact that the administration of the New York Stock Exchange has itself been doing some rather effective work in the field of credit during the last few years. And this marked reduction of Stock Exchange insolvencies has had among us the further effect of equalizing the status of different Stock Exchange firms, and making for an increasingly standardized employment of credit among them. Such methods of credit control, which of course have their parallels in many other fields of American business, raise the plane upon which all American business is done, and by so doing, increase not only the safety but also the democratic character of American business itself.

III

I have little doubt that many of you gentlemen will agree with me when I say that the methods whereby credit is employed in American business are today being revolutionized. In the United

States, we are in fact going through a silent yet very far-reaching revolution in business—a revolution which relates not only to our methods of mass production and mass distribution of goods, but also in the field of finance to the methods whereby credit is extended to business. This change has come upon us so silently and yet so rapidly, that most of us today are still quite bewildered by it. Naturally with so complex a matter, it is exceedingly difficult to reduce this whole economic revolution through which American business is today proceeding, to any common denominator or to any single formula. Nevertheless, it has seemed to me that one very important factor in the whole matter arose from our having become a creditor nation, and in consequence our having to deal with a surplus of capital and credit instead of the situation to which we had been so long accustomed, under which capital and credit were never available in really sufficient amounts to satisfy the vast needs of American business.

One surprising change in the present methods of employing credit has been the almost complete disappearance of old-fashioned prime commercial paper, and at the same time the continual increase in loans made upon security collateral, not merely in Wall Street, but throughout the country. Some keen students of commercial and financial affairs have pointed out that this situation was arising from the great corporate surpluses which American business companies today have so frequently been able to accumulate. Also, as we all know, many of our largest and soundest business corporations in this country have financed themselves quite extensively by the issuance of new securities. As a result, they are now in a position where they no longer need to borrow at the banks in the same way as heretofore, but can finance out of their own liquid resources, such seasonal requirements of their business as

occur. Meanwhile, it is a common practice for such companies to lend their liquid funds for which they have no immediate requirement in their business, in the call loan market. Brokers' loans have in consequence expanded, not only because of these greater offerings of money to lend there, but also because of the greater floating supply of shares which the stock market has had to sustain by reason of this development.

Concerning the soundness or the permanence of this new trend in our New York money market, opinions seem to differ very widely. Speaking from my own standpoint, however, I am not inclined to look upon it as any merely temporary situation, arising from temporarily cheap money rates in the past or in other such rather casual factors. The roots of this latest change in the employment of credit actually go back very far. The use of credit has successively advanced from financing the individual to financing the partnership, from financing the partnership to financing the small corporation, and finally from financing the small corporation to financing the great corporate merger or holding company of our own times. However this may be, it seems at any rate obvious that we must more and more accustom ourselves to a financing of business turnover in this country through the use of brokers' loans instead of through commercial paper or unsecured banking advances.

It still remains to be seen whether this innovation in the financing of business through brokers' loans is as sound and as desirable a system as the earlier methods which today it seems to be to some extent supplanting. On this phase of the matter it is still too early to draw definite conclusions. I cannot myself believe that American business is worse off when it has adequate credit and capital than when it is inadequately provided in these important respects. Yet under the new conditions, we must

all see to it that the extension of credit is judged no less carefully than it has been in the past. However the technical conditions under which money is loaned may be changing, the fundamental necessity of avoiding unsound extensions of credit will of course remain.

It is impossible to review in any general way the employment of credit in modern American business, without acknowledging the vast services which the Federal Reserve system has rendered. American finance no less than American manufacturing and trade has greatly benefitted by the increasingly scientific handling of our national credit problems which the Federal Reserve authorities have been able to inaugurate. The New York Stock Exchange has always cooperated as fully as possible with Federal Reserve authorities in their constant endeavor to stabilize and improve credit conditions in this country. This cooperation has in recent years been witnessed principally in the endeavor which the Reserve system and the Stock Exchange have both made, to collect and make public statistics as to "brokers' loans." The public today, as a result of this effort, has available more real information concerning this class of loans than almost any other in which American banks extensively invest. It goes without saying that the formulation of sound banking and credit policies must always be dependent upon accurate and full statistics, without which it is apt either to cling blindly to mere formulas and dogmas, or else degenerate into hap-hazard and sometimes harmful experimentation. Our whole handling of banking credits would, I am sure, be much safer and more scientific today if as much publicity were accorded all classes of banking loans as are regularly furnished for brokers' loans.

IV

One of the eternally serious problems in any consideration of credit arises from its occasionally fraudulent use. This is of course no less true in the field of long-term credit in which the Stock Exchange operates, than in the field of short-term credit with which you gentlemen are more vitally concerned. The kindred nature of commercial and financial frauds, however, is indicated by the fact that the Better Business Bureau organizations today have undertaken simultaneously to fight both varieties of fraud. The New York Stock Exchange has for several years been deeply interested in this Better Business Bureau movement, and in fact was in large measure responsible for the initial establishment here of the Better Business Bureau of New York. The success with which this organization has attacked the whole difficult problem of frauds and swindling has been gratifying not only to the Stock Exchange but to many other responsible business institutions and concerns in this city. It has always seemed to me a very happy omen for the betterment of American business that both commercial and financial men could in this way unite to drive out fraud and swindling. My principal reason for mentioning this matter here today is in order to urge the credit men of New York to cooperate to the utmost in this important movement. As credit men, you gentlemen are in an unusually good position to see what is going on in business, and I trust that you will continue, not only as an organization but also as individuals, to give the Better Business Bureau all possible benefit from your continual advice and experience. In the campaign against commercial and financial frauds, much has already been accomplished, yet at the same time there still remains much to be done. The movement needs the assistance and the cooperation of all legitimate

trade and business before it can actually be carried to completion.

V

I have already mentioned the fact that the New York Stock Exchange has a very genuine interest in the problems of credit. But from the nature of the case, it is certain special phases of the credit problem which are of most concern to us. Primarily it is the publicity phase of long-term credit in which the Stock Exchange has been most useful to the public.

The New York Stock Exchange is of course basically a market. It is not the real function of the Exchange so much to judge the credit of corporations issuing securities, or to attempt to determine the exact investment value of these securities, as it is to enable others to do this work. In consequence, the New York Stock Exchange has long endeavored to see that corporations, which list securities on the Exchange, make available to the public as much information as possible concerning the important details of their capital structure, their assets and liabilities, and their income accounts. The New York Stock Exchange itself has never endeavored to keep any credit files in such matters. The Exchange simply demands of all companies, seeking to list securities upon it, that they shall publish information concerning themselves, so that it may be available to everyone on an equal basis.

The power of the New York Stock Exchange in this regard has been very greatly exaggerated sometimes. The only power which the Exchange possesses, in endeavoring to compel companies to give publicity of this sort, is to refuse to list their securities. Such a refusal, however, may not necessarily be effective at all, since the given company may list its securities elsewhere under less stringent listing requirements, or may even not list them on a stock exchange at all. Thus, in the last analysis, the

Stock Exchange must employ not so much compulsion in these matters as moral suasion. I am happy to state that more and more American corporations are, themselves, seeing the desirability of wider corporate publicity, and in some cases they have of their own volition gone further in this regard than even the searching and inclusive listing requirements which the New York Stock Exchange has established. With the importance of this tendency toward franker and more complete corporate publicity, I am sure you gentlemen are all in hearty accord. The New York Stock Exchange, through establishing what are really the highest standards for listing requirements anywhere in the world, has in the past not hesitated, in the interests of wider corporate publicity, to curtail considerably the scope of its market and thereby the business of its own members. The New York Stock Exchange deserves, in its unselfish effort for more complete corporate publicity, the support of everyone who is genuinely concerned with the credit questions of present-day American business.

One of the most controversial questions entailed by the listing requirements of the Stock Exchange arises in respect to the frequency of earning statements. The Stock Exchange has long endeavored to secure from companies applying for a listing, an agreement to publish such earning statements on a quarterly basis. Although much progress in this direction has undoubtedly been made, nevertheless there is sometimes considerable opposition on the part of companies to this part of the Stock Exchange listing policy. Companies with a seasonal business, for example, argue that quarterly statements mislead rather than inform the public, by their tendency to make a very bad showing during certain quarters and an exceedingly good showing in others. It has also been urged that such quarterly earning statements provide an undue amount of informa-

tion to competing concerns whose securities are not listed and whose earning statements are therefore not issued on a similar basis. It is also a fact that the listing requirements of the Stock Exchange itself have reached their present inclusive and searching character only after a long evolution over many years. As a result of this fact, the Stock Exchange has in some cases signed agreements with companies listing securities upon it many years ago which called for earning statements only annually or semi-annually. Such agreements, of course, the Stock Exchange cannot now refuse to acknowledge.

The Stock Exchange also finds it difficult to deal with the occasional infractions of its listing agreements after the securities have actually been admitted to quotation upon its market. In such cases, the only power at the disposal of the Exchange consists in suspending or striking from the list the securities in question. But such an action does not penalize simply the issuing company. It may also prove a distinct disadvantage to security owners who have purchased the securities on the Exchange, assuming that they could at all times dispose of them again at will in that market. Such a drastic and violent remedy the Stock Exchange is in consequence usually very loath to employ. I mention some of these details in respect to our listing policy simply to emphazise the fact that the Stock Exchange has and seeks no complete power in all these matters. For this very reason it needs and deserves the cooperation of enlightened business men everywhere in its attempt to place at the disposal of the public as reliable and complete information as possible concerning the actual value of the securities which are dealt in on the Stock Exchange floor.

VI

A final phase of the evolution of our credit machinery and our ability to employ credit extensively in

business, lies in the increasing tendency toward the centralization of credit files and credit information. We in New York are today witnessing a very rapid development of this very sort, for New York has through the force of economic circumstances become the great creditor center of the world, and in this city, more and more each year, are being concentrated not only information upon credit conditions everywhere, but also the financial machinery whereby this credit information can be practically utilized in the daily work of finance. It is important to realize that the foundations of New York as the great creditor center rest not only upon the extensive supply of funds which are brought into this center for investment, but also upon the concentration of knowledge concerning individual and collective credit which is likewise concentrated here. A mere surplus of funds cannot of itself create a financial center, nor can the rise of a great creditor center ever be disassociated from the constant gathering of credit information from all quarters of the earth. It is after all the knowledge, not only of financial technique, but also of individual credits, which lends safety and adds efficiency to the flow of capital into industry and trade.

The credit men of New York, so it seems to me, must constantly face not only an unusual opportunity for constructive work, but also an extraordinary range of different credit problems. It is necessary here to be familiar not merely with the complex and varied credit conditions of this great metropolis, but also with credit as it is being utilized all over the United States. As if this were not enough, there has recently been added the necessity of studying and gauging credits all over the world. New York has become perhaps the leading international financial center, with an increasing interest in the problems of foreign credit each year. For this reason it will depend upon the ability of our

credit men in coming years to familiarize themselves with the many and novel questions of international credit. This surer grasp of foreign credit situations is very greatly needed here in New York, not only in the field of short-term commercial credits, but but also in that of long-term investment credits. Every year the already vast foreign investments of the American public are being heavily increased. In the Stock Exchange we have long recognized the great need of wider and more expert knowledge of the credit conditions which underlie these great foreign security imports which we are making. Indeed, it might be fairly said that the development of New York as a leading international center of finance can go forward no more rapidly than the collective ability of those whose task it is to master this new and complex subject of international credit.

The great expansion in American finance during recent years has led us all to reconsider the present status and future tendencies throughout the whole field of credit. The most obvious result of the great expansion which the New York financial center has already witnessed is the great building programs, and the added physical facilities for carrying on the work of the stock and money markets. Nevertheless, this is by no means the whole story. It is not enough for us to provide the merely mechanical facilities for more extensive credit operations, such as new bank cages and vaults, or new Stock Exchange posts or tickers. There is also the intellectual problem of mastering new fields of financial and credit knowledge, and the moral task of maintaining throughout this center what the Stock Exchange has long known as the "just and equitable principles of trade." In the future, we, in New York, must plan not only for the expanded financial operations which are necessitated by our constantly growing business and national wealth, but also for those essentially spiritual problems which must

accompany them—the imagination to foresee, the quick comprehension to understand new and changing economic problems, the critical analysis to maintain sound standards of credit, and the patience to solve the credit problems provided by the ever-changing economic world. Only by success in these matters of the mind and the conscience can New York long maintain itself as the international creditor center of the world.

FINANCING INDUSTRIAL DEVELOPMENT

Address before The Atlanta Chamber of Commerce, Atlanta, Georgia, January 18, 1929

FINANCING INDUSTRIAL DEVELOPMENT

It is with very real pleasure that I have come to address you today. Although this happens to be my first visit to Atlanta, I must confess that I have felt entirely at home in this new metropolis of the South, not only because of the very generous hospitality for which your countrymen have been noted, but also because of the great national industries which are located in your city. In fact, an industrial directory of your major industrial enterprises in Atlanta reads very much like a list of the best industrial securities on the New York Stock Exchange. It is very evident to me that Atlanta business men have in their keeping many of the industrial assets and equities which, in certificate form, are bought and sold upon the organized securities market in New York which I happen to represent.

II

It is a striking fact that the economic development of this country has in the past occurred in the main from East to West. Due to this fact, our Southern states were long somewhat out of the regular line of march taken by national industrial progress, and thus the industrial development of your remarkably rich and varied natural resources has been long delayed. The more one thinks about this situation, the more curious it seems because of the fundamental lack of logic behind it. Frequently the slow industrial development of the South has been blamed upon the climate—that universal scapegoat for all manner of occurrences which cannot be readily explained. Some used to think that it was because the Southerner had no liking for business. Both of

these reasons, however, have been very completely disproved by the remarkable industrial evolution which the South has experienced during recent years. It is also true that today some of the ablest commercial and financial leaders in the North are apt to speak with a Southern accent. To me at least, it seems apparent that not least among the real economic resources of our new South is a very distinct quality of business ability.

But since the economic development of the South has been undertaken in comparatively recent years, it is still very largely virgin territory, in spite of the fact that your resources are really located at the very doors of our Northern centers of population and our oldest mercantile and industrial sections.

In some respects the list of securities traded in upon the New York Stock Exchange provides a very accurate panorama of the national economic development of this country, and we in New York who are security merchants and security brokers have become very fully aware of the rapid and extensive industrial transformation which has been going on here in the South, from the securities which in recent years have entered the New York Stock Exchange market. Apart from your extensive production of cotton, timber, fruits and other important agricultural products, your extractive industries—especially perhaps your coal, iron and ceramic clays—have already attained national importance. Finally, Atlanta has entered vigorously into manufacturing. That the basis of this aspect of your development is sound, can readily be seen not only in your rich deposits of fuel and your extensive undeveloped water power, but also the strategic location of your city, which has so well been called the "Gate City of the South." Although so much has already been accomplished here, it seems obvious that your community has only really started on the long course of its ultimate economic development, and for many

years it is likely that regular annual growth will here be a part of your ordinary business routine.

III

It has of course been inevitable that the very swift and very striking economic development here in the South has created for you numerous financial problems, and it is primarily concerning a few of these that I have come here to speak to you today. Anyone who has had the opportunity of seeing your undeveloped natural resources and your great economic advantages, must be firmly convinced of the steady need for capital to develop these things in the future. It is, however, important to consider just how this capital can be secured and rendered available for your purposes. In large measure, of course, your banks can continue in the vigorous and enlightened policies which they have shown in the past, in nurturing and fostering the rise of your industries here. In this respect you are, of course, fortunate in being the seat of the sixth Federal Reserve district, and already, as we all know, your Atlanta Reserve Bank has become even an international factor by the sound money facilities which it has been instrumental in affording the friendly but independent Republic of Cuba. In the future as in the past, the industries and commerce of Atlanta will undoubtedly obtain from our splendid Federal Reserve System the same important financial facilities from which other sections in the country have likewise benefited.

Industrial development, however, involves long as well as short-term financing, and the sale of stocks and bonds to the public as well as banking loans and advances. Indeed, as I have already pointed out, your section of the country has already drawn large amounts of permanent capital here through the New York securities market, and in

the future this trend will and should continue. Much of this financing has been done by American industrial corporations doing a national business, and through this fact undoubtedly your industrial development has been greatly facilitated and speeded. It is highly important to such a new but rapidly evolving section of our country as this, that no impediment be placed in the way of the long-term security financing which the great economic opportunities here so manifestly justify and deserve.

IV

One very important and vital factor in security financing today centers in the question of stock market loans. Although this subject has become a somewhat controversial one, it is highly important for those of us who wish to see the continuance of our present business prosperity to understand the basic economic function which these loans regularly serve. It is of course possible for stock market loans to become over-large, just as it is possible for any particular form of financing to grow out of proportion to the other elements in our financial mechanism. But I am not so much interested either in the present or the future total amounts of stock market loans as I am in their fundamental economic functions, which have very commonly been misunderstood, and it is that aspect of the question which I am primarily anxious to emphasize.

When a new security issue is brought out, as a rule the outright investor is at first rather skeptical about it. This is altogether natural and inevitable, since such investors cannot easily judge of a new security's actual permanent value. Of course gilt-edge government securities, or amply protected mortgage bonds, largely speak for themselves, and here the outright investor will usually show an immediate confidence in them and an immediate

willingness to purchase them. But when industrial securities, and particularly the share securities of relatively new industries, first appear, investors will not ordinarily respond at once in this way. They wish to buy only seasoned securities. They always prefer to fill their investment boxes with shares which have been on the Stock Exchange for a period of years, which have experienced crises and depressions there, and which have stood up well under adverse conditions in the past. For just this reason, large industrial share financing can only rarely be done with the assistance of outright investors alone. There practically always remains a considerable portion of the new industrial share issue which investors will not buy and absorb immediately. It is therefore necessary to have security speculators who will hold such unsold market supplies of new securities, mainly with the assistance of bank credit, until the issue has become seasoned and can be absorbed by the investing public of the country. It is the carrying of this market supply of new and unseasoned securities which necessitates the employment of stock market loans. Every financial center of importance in the world makes such loans, and to the extent that there is industrial progress going on around about it, it must make such loans. To a large extent, indeed, the industrial energy and progress of a nation can be measured by the degree in which such security loans are regularly contracted.

The critics of stock market loans are disinclined to criticize them when they are made by underwriting and issuing houses, since here the ordinary merchandising function of these loans is perfectly obvious. On the other hand, there has been considerable criticism of stock market loans not contracted to carry brand-new underwritings, but rather securities which underwriting syndicates have long since sold to investors or speculators, and thus closed out their original marketing responsibility.

When it comes to the stock market loans which are contracted to carry securities for margin customers of stock brokers, it is necessary to consider the way in which a stock market ordinarily distributes issues to investors. Securities, not being necessities of life, are as a rule comparatively difficult things to sell. Also, investors do not consume the securities they buy in the same way that a buyer of wheat consumes it. Securities, even when held by outright investors, can well be sold back through the stock market at any time. In consequence, the gradual distribution which the stock market effects from speculator to investor, as the securities concerned become really seasoned, is constantly subject to interruption. It is one thing to sell securities to investors, and another thing to keep them sold to investors, as the long history of the world's stock markets amply testifies. Security marketing through a stock exchange, although basically the same kind of a distributory system as is employed with any other class of property, is by reason of this tendency of outright holders to resell to holders on credit, rendered more complex.

Because of this complexity of the work which stock exchanges do in slowly distributing securities from speculative to investment hands, many people wholly miss sight of this very important function. It is to be regretted that more adequate statistics on this phase of long-term financing in this country are not available. However, the United States Steel Corporation has regularly published quarterly statistics which give us a fairly accurate idea of the amounts of its shares held at each quarter by outright investors and also by security speculators. Over a period of years, these statistics are, to me at least, extremely impressive. They show that in 1909, only about one-third of United States Steel common stock was actually held by investors, and approximately two-thirds of it at that time was held by

security speculators. We must recall that back at that time, United States Steel common shares were not as yet a seasoned investment, and the conservative investors of that time should not be criticized for being unwilling to lock such stocks up in their boxes and forget about them. As time went on, however, the increasing stability and financial resources of the Steel Corporation rendered its common shares more and more a stable and secure investment, with the result that investors steadily bought the shares in the stock market and took them out of the speculatively held floating supply there. As a result, by 1913 one-half of Steel common stock was apparently held by outright investors, and one-half by security speculators. With the subsequent progress of the company, the confidence of our investing public in the shares continued to increase, and by 1921 over three-quarters of the shares came to be held by investors and less than one-quarter by speculative holders. No one can review these figures without realizing that the stock market day in and day out constitutes the greatest single mechanism which we have in this country for selling securities to investors in an efficient and inexpensive way, and also that the stock market loans which enable securities to be held until investors are willing to absorb them are an absolutely essential feature of our long-term financing facilities. Any serious impairment to stock market loans would inevitably result in an increased unwillingness on the part of security underwriters to float new security issues, since in the work they could no longer depend on being powerfully supported by speculative as distinquished from investment buyers of their wares.

The facilities for making stock market loans are one of the very oldest parts of our national financial mechanism. For three-quarters of a century, the major security issues of the country have passed slowly from brokers' loan envelopes through the

stock market into the hands of outright investors. Any financial system must ultimately be judged by its results. One can scarcely survey the vast extent of the American railway system today, our unparalleled extractive industries in this as well as in other parts of the country, and our manufacturing enterprises which through liberal financing have attained the huge capitalizations that today permit them to engage in quantity production, without realizing that the stock market in Wall Street has ever since 1850 performed a very vital service to the economic development of this entire nation.

New industries particularly have need of the support of the speculative buyers of securities, because the risks which they involve as untried projects are, as a rule, too great for the more conservative outright investors to sustain. In the earliest days of the New York financial market, the conservative capitalists would not even invest outright in a bank stock, but insisted on keeping all their wealth in land or land mortgages. By the time that bank stocks and United States Government securities had become seasoned, our railroad stocks came into the market, and had mainly to be carried by speculators until they became seasoned enough for investors to buy them. With the gradual stabilization of our great railroad companies in this country, public utility and mining and petroleum industries were created, whose security financing had to be done largely by speculators in the beginning. Twenty years ago, conservative investors in this country would only occasionally be willing to buy and hold outright an industrial security. I have already alluded to the large extent to which even the shares of our premier industrial company—the United States Steel Corporation—had to be carried by speculators until investors were willing to buy them.

In this dynamic country of ours, progress con-

tinues. We are always faced with new industries of uncertain immediate prospects but great future potentialities, and today, just the same as a century ago, securities of this type have to be carried by speculators before they can be absorbed by investors. Today we are witnessing the undoubted beginnings of commercial aviation in this country. Science has revolutionized the art of speedy communication. What the end of this development will be, no one can certainly say. Conservative investors today may hesitate to buy the shares of companies of this kind, in the same way that they used to be unwilling to buy our best bank, railway or industrial shares. If these new industries are to be adequately financed, they must again come to the security speculator for a great part of the funds which they require.

It has therefore long seemed to me quite beside the point to condemn security speculation in broad generalities. Attempts to curtail or prohibit the free speculative financing of industry in this country, would inevitably result in a sharp check to our economic progress. Actually the security investor depends very vitally upon the security speculator to create new industries, and nurture them into sufficient strength to constitute them seasoned and conservative investments. Investment and speculation are thus inseparable processes, and we cannot condemn the one without crippling the other.

A final aspect of stock market loans should be, I feel, clearly emphasized here. As we all know, the majority of such loans are made in New York on the collateral of securities listed on the New York Stock Exchange. On the face of the matter, the borrowers of these funds are members of the New York Stock Exchange; but when we go back of the Stock Exchange member's name, we immediately find that almost always he is contracting these loans in behalf of security customers who live all over the United States. The credit obtained by New York stock

brokers from their collateral loans is in this way diffused in security dealings which originate in all parts of the country. A large amount of stock market loans in New York were created essentially because security buyers right in this very city wished to purchase and carry certain securities on credit. On the demand side of stock market loans, therefore, we are dealing with a national problem and by no means a local New York City problem.

On the other hand, as I have already stated, the speculative purchase of securities constitutes an indirect but powerful method of financing companies all over the United States. You have right here in Atlanta many very large national business enterprises which have obtained the funds with which they are operating through the New York stock market in this way. In consequence, loans made in the New York financial center produce a flow of permanent capital into communities all over the United States, and constitute a most important facility for the adequate financing of industry in practically every part of this country. Whatever one may care to think about stock market loans, he must at least begin by recognizing that they are part of a national problem. There is no greater mistake than to think of stock market loans as something affecting only the dozen odd business blocks which constitute the New York financial center in Wall Street. In many ways, new and developing parts of the United States, like this great community of the Southeast, have a more vital stake in the facilities for continued industrial financing which stock market loans effect, than older and more fully developed industrial sections of the country, whose enterprises have largely obtained their permanent capital, and which do not, to the same extent as your enterprises, face the same future possibilities of growth and the consequently imperative need for the employment of greater amounts of permanent capital.

V

It is the history of industrial communities, not only in the United States but throughout the world, that their foundations are laid mainly with borrowed money, that subsequently prosperity enables them to generate excess capital, and that sooner or later these capital savings allow them to pay off their debts to their creditors, and become in turn creditor sections with capital to invest elsewhere.

The United States as a whole has only recently achieved economic maturity, and thus obtained capital which seeks investment beyond our borders. In this new industrial part of the South, the demand for home investment is still relatively greater than in the older industrialized sections of the North. Yet even here in the Southeast you are coming rapidly to face the very important problem of investing surplus capital created here not only in your own immediate community, but also in other parts of the United States and to some extent abroad. This very significant financial transformation of the American Southeast has clearly revealed itself in the spread of investment banking houses here of both a local and a national character. In the New York Stock Exchange, its effects have been seen by the constantly increasing amounts of Southeastern capital which have been seeking investment through the New York market. This is of course the reason for the remarkable extension of our stock ticker quotation facilities through the Southeast in the last few years, as well as the extensive establishment here of branch offices and correspondent firms of New York Stock Exchange houses which have brought to your doors the facilities of the New York capital market over private brokerage wire systems. Undoubtedly this growth in the investing power of the South will under continued prosperity increase far beyond its present extent, and your community

will thereby inherit the financial problems which have so long preoccupied the older industrial sections of the Northeast. Just as New York can today benefit from the longer experience of the older creditor nations of Europe, so too Atlanta can benefit by the experience of New York or Boston or Philadelphia, as the oldest financial centers in America.

The coming of what might be called the investment era in any industrial community is bound to create at first considerable confusion of thought and understanding. When England became a creditor country over a century ago after the Battle of Waterloo, there was considerable criticism concerning the new tendency to engage in foreign loans. About one hundred years afterwards, when this same kind of economic transformation occurred in this country, similar confusion of thought and needless alarm have also been occasioned. Such initial difficulties, however, rapidly pass away when the great advantage of enjoying an adequate local supply of capital is thoroughly realized. My prediction is that Atlanta must inherit many of the peculiar problems which arise out of the investment of a financial surplus. You also will have to cope with new problems of financial organization. You will have to exercise a vigilant watch lest the savings of your newly created investment class here are dissipated through the operations of security swindlers. Some of the more old-fashioned element in your community may feel a distinct dismay when they see difficulties of this order spreading from the older Northeastern financial centers into your own community. And yet the impartial reading of history leaves no doubt as to the higher standards of living and the greater possibilities of spiritual as well as material progress which adequate local supplies of capital regularly afford.

At the present time America is, paradoxically enough, endeavoring to function as a creditor nation with the public psychology and the financial organ-

izations and methods which have grown up among us during the long century when our nation was a debtor country. For this reason, the accumulation of a national surplus in the form either of securities or loans upon securities is apt to appear like mere inflation. Of course progress itself can be overdone, and there is such a thing as investing capital in our industries more rapidly than immediate economic circumstances may justify. Even so, I would myself greatly prefer this situation to one where the proper financing of our industries and our commerce was continually hampered and interrupted by an insufficient supply of capital. In this respect, the industrial growth of our South is likely to experience less real difficulty than did the former development of our older Northeastern industrial centers.

In any case, the spreading tide of financial prosperity and security investment is today not only a harbinger and indeed a creator of industrial progress —it is also a powerful force unifying the sometimes far distant industrial sections of the whole nation. Our large business corporations and even our financial institutions are no longer Northern or Southern, but rather simply American. New York is more than our largest city community—it is our national financial market-place. The financial facilities of the New York Stock Exchange have long since over-passed interior border lines, and today provide capital for industry in all parts of the nation, and investment securities for all parts of the Union. Our continual economic progress must not be interrupted by misconceptions of the proper role of capital in industry, or inability on our part continually to place capital at the disposal of increased production. Heirs to the splendid heritage of American industry and finance founded under such difficulties in the past, it is for our own generation with vision and courage adequately to face the tremendous and ever-expanding economic horizons of our national future.

REAL ESTATE AND THE CAPITAL MARKET

Address at the Annual Banquet of the Real Estate Board of New York, at New York City, February 2, 1929

REAL ESTATE AND THE CAPITAL MARKET

It is, I assure you, a very great privilege and pleasure for me to be here today. I must confess, however, that I feel somewhat diffident in addressing this audience of real estate experts on a topic which has largely to do with their own business. I cannot myself claim any especial knowledge of the very distinctive and complex tasks in which you gentlemen are engaged. It is nevertheless true that modern business in real estate and in securities generally contains many common factors and common interests. Both are concerned with our national problems of investment. Modern real estate enterprises are frequently organized in the form of stock corporations, some of which are indeed listed on our stock exchanges. It is also true that the New York Stock Exchange, like every other important business institution on earth, necessarily has a real estate problem of its own. This has been particularly the case since the war. The great expansion of the capital market on the New York Stock Exchange has necessitated more and more physical space for its adequate conduct, not only in the New York Stock Exchange building itself, but also in the offices of its many firms. This expansion of Stock Exchange facilities has of course not been confined to the Wall Street district alone. Branch offices of Stock Exchange firms have been established not only throughout the rapidly growing up-town business district in New York, but throughout our entire metropolis, and indeed throughout the whole United States. For this reason there are closer contacts than ever before between stock brokers and the real estate business, and also the deeper need of hearty cooperation and mutual understanding.

II

It is surely obvious that the real estate business is and always must be one of our most basic industries. It is connected by almost infinite ramifications with our national commerce and industry, and with architecture and the other arts. Real estate itself is of course the oldest species of investment which history records. For many centuries, the ownership of land was in fact practically the only measure of wealth, and also the only basis of political power. Even as recently as one hundred years ago—and in the long development of your business a single century is not a long period—land was, in the United States, the favorite and almost sole form for the conservative placement of capital. Mortgages on land were our earliest securities, and the vast outstanding aggregate amount of real estate mortgages in the United States and other countries today still bears witness to the very basic and fundamental character of your business.

In the early years of our Republic, when the New York security market was still a very small and inconspicuous affair, the conservative capitalist almost invariably invested his wealth in land mortgages or real estate itself. The first pre-eminent capitalist in New York City, John Jacob Astor, is still remembered for his great faith in the future growth of this city—a faith which is still symbolized in our own day by the extensive interests of his descendants in the firm foundation upon which this great city today stands.

With the coming of the industrial age, there occurred a remarkable expansion in the development of stock corporations of all kinds, in practically all the different fields of business enterprise. The securities of these corporations, particularly after they attained important size, became a favorite species of investment for capital. In the early price list of the New York Stock Exchange anyone

who is interested in the historical development of American business life can trace the successive waves of corporate financing which have gradually built the modern world in which we live. The earliest securities in the New York market were bonds of our Federal Government, together with shares in newly organized banks and insurance companies. A little later there occurred heavy flotations of state bonds contracted to build canals and even railroads. But the extensive issuance of American corporate securities and the organization of a broad market for them on the Stock Exchange did not occur until the great era of railroad building began. From all these early business enterprises organized in corporate form, the older business in real estate and land mortgages of course benefitted enormously. Our early banks and insurance companies lent important credit facilities to the carrying on of the contemporary business in real estate. The establishment of superior means of communication led directly and immediately to the enormous enhancement of real estate values throughout the country, and provided a profound stimulation to building and construction along the arteries of commerce thus established. Still later, the successive waves of financing mining and the extractive industries, our public utilities, and finally our great industrial and commercial enterprises, were accompanied step by step with a similar stimulation to dealings in real estate, and to a constantly growing volume of new construction.

This force has continued into our own times and promises to continue into the future. The new industry of commercial aviation, already financed by extensive security issues in Wall Street, is now creating a need for adequate landing sites and air ports with which no doubt real estate men like yourselves are already vitally concerned. It is therefore the greatest of fallacies for any real estate

man today to feel that the security market is a sort of competitor to him in his own business. Actually, the enormous amounts of capital which through the security markets have been continuously poured into our stock corporations, have continuously provided a demand for land and construction without which the real estate business could never have become the enormous aggregate enterprise that it is today. Owing to the basic character of the real estate business, corporate security flotations in the future must similarly serve sooner or later to increase the demand for land and construction. It seems to be a fact that, just as most of our profits in business are derived originally from the soil, so to an ever-increasing extent these profits tend to return again to investment in real estate either for residential purposes or for increased industrial production. I have in fact been told that when the stock market proved generally profitable to American investors, real estate about New York was soon stimulated, particularly in our residential suburbs. If this is a fact, it only testifies as to the close connection which really exists between these two great allied and kindred fields of investment.

The real estate business has a further similarity to the business in securities in respect to the many problems which arise from speculation, and you gentlemen as well as the security investors of the country have constantly to concern yourselves with questions of this sort. The market for real estate, as well as that for government and corporation securities, has been in the past alternately elated by inflation and depressed by deflation. There is the same necessity in both markets to maintain an intelligent analysis of true values, and to halt unsound and artificial movements in prices. It is however true that we all tend to benefit from the same constructive forces, and to derive harm from the same fallacies and disorders in business. You

gentlemen, no less than the security brokers and dealers of New York, must more and more strive by collective action to drive from the field of legitimate business the fraudulent promotor and the swindler. Some years ago the New York Stock Exchange took a leading and decisive part in the establishment here of the Better Business Bureau of New York for this very purpose. This specialized fraud-fighting organization has done valiant work in detecting security frauds and bringing the evidence upon them promptly to the attention of our public authorities. I have spoken many times on this subject of stamping out swindling in this country, and I do not intend today to impose on your good nature by continual repetition of what I have already said on the subject. But I confess that it has been very gratifying to me to learn that the Better Business Bureau has been invited by the leaders in the New York real estate business to include in its ordinary operations the fighting of real estate swindlers too. No business in this country, however basic and however legitimate at heart, is altogether free from what President Roosevelt once called a "lunatic fringe" of parasites who attempt fraudulently to benefit by the well-earned reputation for honesty and equitable dealings established by legitimate and well managed business firms. The cure for this stubborn swindling evil seems to lie in constant vigilance and complete cooperation between private business and our public authorities, stimulated and concentrated in just such an efficient fraud-fighting agency as the Better Business Bureau of New York has so amply proved itself to be.

III

No one can reasonably doubt the substantial and permanent value of good real estate, although its value is naturally subject to fluctuation and change

arising from many causes. The proper analysis of real estate values is of course a highly technical science in itself, and necessitates an intelligent appraisal of many factors far in the future. But there is always with real estate the comforting reflection that at least it cannot easily disappear or fly away.

One of the principal difficulties with real estate as an investment, of course, lies in the relative difficulty the investor frequently experiences when he wishes to sell it quickly. Usually, too, it is most difficult to sell at just the times when the desire and perhaps even the need to sell are greatest. Real estate is of course not alone subject to this difficulty, but undoubtedly its illiquidity becomes at times more pronounced than that of most other kinds of property, and certainly more than securities which are listed on an active organized market.

The difficulty in this regard arises from the basic fact that it is as a general thing very difficult to standardize most real estate. Of course this has to some extent been successfully accomplished in our modern large-scale real estate developments. Nevertheless, it is quite generally true that every plot of ground is an individual commodity, and must be purchased and sold as such. The high degree to which real estate selling and brokerage has been organized and specialized, in itself illustrates fundamental difficulties on this score which real estate dealings necessarily impose on the firms specializing in just this business.

This situation sharply contrasts with the conditions under which business is done on the Stock Exchange. One of the major benefits of securities consists in the fact that the different shares of a given stock issue, or the different certificates of a given bond issue, are by definition exactly alike. This complete standardization of security units enables them to be very easily dealt in. For this

reason, it has been possible in all modern countries to form organized markets for such dealings, with the result that there are today approximately two hundred and fifty different stock exchanges in the world. The existence of these organized and continuous markets for securities has conferred a high degree of instant negotiability upon both government and corporate securities. Still another advantage has also arisen from this fact. Not only will investors more readily purchase outright securities which they know they can speedily sell again when they wish, but also banks and other money lenders will more willingly make advances upon the collateral of such securities. The lender on collateral must naturally always consider the factor of the negotiability of the collateral, since in case the borrowers are unwilling or unable to repay him, he must reimburse himself for his loan by their sale. Recently we have been hearing much discussion of the so-called "brokers' loans" in the New York market. Were it not for the fact that most of the securities which serve as collateral for these loans can be and are daily bought and sold upon the New York Stock Exchange, such loans would in fact constitute a highly illiquid element in our banking structure, and in all probability could never have attained their present total amounts. But as matters stand, call loans on security collateral constitute the safest and the most liquid form of loan available to American banking institutions. It has frequently been demonstrated in the past that rapid expansion in security values, and in the loans made upon security collateral, are by no means as dangerous to the whole community as a similar expansion would be in real estate values or in general commodity prices, simply because a security market can be so much more easily liquidated. This fact in turn is, as I have already pointed out, mainly due to the high degree to which it has been possible to organize the securities market on the Stock Exchange.

IV

Thus far I have spoken of the real estate business as if it were utterly unacquainted with the issuance of large security issues. As we all know, this is far from the case. Indeed one of the major financial developments since the war has been the increasing employment of security financing in furthering the vitally necessary work of real estate development and construction. In large measure, too, real estate securities are coming more and more to resemble in their size and their internal standardization, the corporate security issues which are marketed on our stock exchanges. The original land mortgages and building loans were apt to be almost as individual and non-standardized securities as the particular pieces of improved or unimproved real estate upon which they were based. Because of this fact, it was long impossible to deal in such issues in a wholesale manner. But in recent years, the constantly increasing size of real estate mortgage issues is making it more and more possible to organize a market for their continuous purchase and sale, and in this way to lend to these issues that ready negotiability which has long proved so important a consideration to investors and money lenders alike. It has been on this basis that some real estate bonds have been listed on the New York Stock Exchange, although as yet the great mass of real estate mortgage securities has no organized market.

There is another modern tendency in this regard which has also attracted the attention of thoughtful students of finance. More and more, real estate organizations have taken the public into partnership with them by adopting the corporate form, and by issuing shares as well as bonds. Such large-scale real estate firms are thereby enabled to function as holding companies as well as operating units in the industry. Evidence is not lacking that there

is emerging a type of organization in the real estate field very similar to the specialized investment trust with operating functions in the manufacturing and commercial field. From the standpoint of the investor, this evolution promises many substantial advantages. For one thing, it enables the small investor to enjoy a wide diversification, not only in different real estate mortgages, but also in the equities represented. The older London financial market has for many years been familiar with holding and operating real estate companies of this kind, whose securities are listed in extensive amounts on the London Stock Exchange, and generally enjoy there the same high investment rating that attends the securities of the successful standard British investment trusts.

More and more the American public is showing a preference for investment in common shares which possess possibilities of continued appreciation in price as the equities which they represent gradually accumulate and as the dividend rates are gradually increased. It is probably in the future that this preference will continue to be evidenced, although inevitably there must be also an increased market for bonds. I believe personally that this rather recent popularity of shares as long term investments constitutes a factor with which financiers and business men must permanently reckon in the future. In real estate financing, the wider employment of share financing, if this could be soundly effected, should do much to facilitate the flow of investment capital into the basic business of land ownership and building construction.

Recently there has, I believe, been some discussion as to the advisability of establishing in New York a separate organized market for dealings in real estate bonds and mortgages. Perhaps this thought has been stimulated by the tendency which is so widespread in the United States today, to establish new

stock exchange markets even in the exchanges which have long been devoted to commodity trading. This is a large subject in itself, and I have no intention of attempting here to deal with it at length. It is necessary to point out, however, that successful stock exchanges have rarely if ever been organized before a definite demand for their services has been clearly evidenced. The New York Stock Exchange, for example, has grown up by a process of slow evolution over the course of more than a century. There is in this great country of ours still plenty of room for new stock exchange organizations, since today billions of dollars worth of sound and legitimate securities still possess no regular organized market. At the same time, one cannot read the financial records of the past without realizing the danger to the American investing public which the sudden rise of unnecessary and badly managed security markets has at various times constituted. There is little use in attempting to organize stock exchanges merely to create memberships to sell.

In the higher development of American finance and American business, however, the tendency to organize both our wealth and our business enterprises in the form of stock corporations, and also the tendency to establish organized security markets for the securities thus created, appear to grow more powerful every year. If this trend continues, it is probable that the effort to organize markets for real estate securities will attain more and more force and momentum as time goes on. In this evolution, I am sure, such experience and knowledge of the administration of security markets as the New York Stock Exchange possesses will very gladly be placed at the disposal of any new organization of permanent and legitimate character desiring to increase the marketability of sound real estate securities.

AN INDISSOLUBLE FRIENDSHIP

Address at the Washington's Birthday Dinner of The American Club of Paris, Paris, France, February 22, 1929

AN INDISSOLUBLE FRIENDSHIP

I very deeply appreciate the distinguished honor of your invitation to address you on this significant occasion. It seems most appropriate that Washington's birthday should be celebrated here, in the very land which was so quick to recognize his great qualities, and from which in the darkest days of our War of Independence he drew such great intellectual and material assistance. It provides Americans with the very happy occasion for celebrating not only the creation of their own Republic, but also the founding of that traditional friendship and affection for the great sister Republic of France which has ever since been so powerful a factor in world affairs.

Sympathy between France and the United States has always been instinctive. One can in part attribute the great help which France extended to America one hundred and fifty years ago, to the wish of the King of France to embarrass Great Britain, yet such temporary exigencies in European politics cannot explain the generous enthusiasm of Lafayette. The United States was impelled to engage in the recent war to assist the Allies as well as to protect the integrity of our own country. Beyond the extent of material causes or the cold dictates of logic, there has always been in our national relations that instinctive loyalty to an old friendship forged in the early days of liberty and democracy in France as well as in America.

In recalling the period of Washington, we must at the same time remember the profound influence of French political philosophy in the early days of our Republic. The genius of Voltaire, of Diderot and of the Encyclopedia flashed far beyond the bounds of France, and illuminated the path of

democratic government on both sides of the Atlantic Ocean. Our Republic no less than that of France drew its inspiration from this French school of political idealism, with its emphasis upon liberty, equality and the natural rights of man. The American Declaration of Independence largely echoes the convictions of Voltaire, the aspirations of Rousseau.

One hundred and fifty years is a long time ago, particularly to a young country like the United States. Both the French Revolution and the American War of Independence occurred on the very eve of that great era of scientific progress which has so completely transformed the world in which we live. Not only the conclusions but even the premises of the political philosophy upon which these epoch-making struggles were based, have since been greatly modified by the hard lessons of experience. Nevertheless, that trust in political democracy, enunciated so long ago by the French philosophers of the eighteenth century, is still the inspiration of our republican forms of government. The same intellectual stimulus which originally led to the establishment of the Republics of France and the United States, still provides a potent bond of sympathy and harmony between them.

II

One does not, of course, need to be an American to admire France, and especially this old capital of France—so well and so justly called the "City of Light." There is an old saying that every man has two birthplaces—one the place where he was born, and then—Paris. This is not an idle aphorism —it is a genuine tribute to the intellectual and artistic heritage which this ever-beautiful and ever-inspiring city has always afforded civilization. Paris has always so unfailingly been a bringer of rich in-

tellectual and artistic gifts to the world. Centuries ago, upon the rising ground where the Sorbonne now stands, Abelard symbolized that spirit of courageous and intelligent inquiry which has since, in the continual development of scientific knowledge, transformed the world.

If I have one regret in commenting upon the influence of French culture in America, it is the great need of adequate English translations of the many admirable works of French scholarship, which so uniquely combine keen intelligence with grace and clarity of expression, profundity and wisdom with charm of form. French art speaks in a universal language, but unfortunately French science for its fullest appreciation still needs the translator. This seems to be particularly true in the field of history and economics. The long line of great French economists and financial writers are too little known in America. For a young country like the United States, French economic history is very rich in precedent, very fruitful in example and experiment. It would be a real service to greater American understanding and knowledge of France, if many very masterly works of French scholarship could be rendered available in good English translations to our vast and rapidly increasing American reading public.

III

The impact of French culture, at least to an American like myself coming to Paris only occasionally and for short visits, always leaves one with a feeling of strangeness and unfamiliarity despite its universal appeal. That this should occur with Americans is all the more astonishing when there exists in the United States an instinctively friendly feeling for France—an instinct, I may add, which is deepened by our mutual memories of blood shed

in common for liberty on the battlefields of two continents.

There is entirely too much French blood in the American people today, to attribute our difficulties in understanding each other entirely to race. In this day of widespread public education, our different languages, also, do not really account for it. The truth of the matter seems to be that our social and economic values are so very different, that mutual comprehension is rendered difficult and mutual misunderstandings easy.

In such matters, age is naturally an important factor. Modern France has deep roots in a very long and continuous past. By comparison, America is still a new country. Furthermore, for over a century the principal national effort of the American people has been expended in the colossal task of subduing a continent—a task whose vast scale and almost unlimited demands upon our energies and attention are often insufficiently realized in Europe. We are still earnestly and inevitably engaged in America upon road-making and bridge-building, which here in France were sometimes accomplished, often astonishingly well, under the Roman Caesars.

It is furthermore true that in Europe the industrial age, when it arrived, had to be super-imposed upon a civilization very old, and—granted the facilities for the production and the distribution of goods at its command—very intelligent and vigorous. America, however, was a very scantily populated pioneer country when the nineteenth century ushered in the industrial revolution. It could develop its future with little reference to old habits and fixed institutions in its own past. We could readily build without having first to tear down.

Just this absence in America of high social and economic development before the nineteenth century accounts in large measure for that bewilderment which many of our soldiers felt when they arrived

for the first time in France during the war. They failed, particularly perhaps, to understand the French peasant-farmer, holding with such extraordinary tenacity to his ancient acres and cultivating them with an experience on the soil as old as France itself. For American agriculture has always been of a quite different character. Having at its disposal vast tracts of new and fertile soil, it has often been able to employ machinery in its cultivation on a wholesale scale. Our farmers have also shown comparatively little attachment to localities—they have steadily shifted the scene of their operations westward as new lands were opened and old lands began to require extensive fertilization. Indeed, as we know, some of our wheat farmers in our northern states bundle their families in their automobiles each autumn, and set out like migratory birds for a winter in the warmer climate of Florida or California.

Similar differences have existed between the French and the American industrial worker. French industry has behind it long ages of hereditary training and skill, and much of the fine spirit of the old guild craftsman. The individual French worker is apt to be the master of many instead of only a few stages of production, and to impart his own personality and taste to the object which he produces. In America, on the other hand, the unimpeded development of machine industry has led to a specialization, a marked division of labor, and more standardized products. The systems are so very different that it is rather idle to argue their comparative merits. It is, however, only fair to point out that today French and American producers are each seeing some virtues in the others' system. The great forward strides in quantity production which some French automobile manufacturers have made represent a leaning to American methods, while recently our own Henry Ford astonished us

all by endeavoring to make his new cars objects of beauty as well as utility.

A final factor of difference between our countries is in their geographical situation, which produces quite opposite results in French and American public opinion. France, like other European countries, must always concern herself with the supremely important question of her national security from invasion. Such a preoccupation concerning the integrity of national boundary lines is almost unknown in America. The vast boundary line between Canada and the United States, although it runs close to some of the largest Canadian and American cities, is throughout its length of thousands of miles completely unfortified. No one ever really fears foreign aggression upon our frontiers, and this makes it quite difficult for many Americans to understand in a realistic way the quite different situation on the Continent of Europe. Sometimes, we must admit, we are apt to make the great mistake of thinking that our more fortunate situation is due entirely to our superior moral character, and on this basis to deliver sermons to other nations. In the interests of international friendship and understanding it would be well if we heard rather less of this sort of thing in the future.

Naturally, a prerequisite to understanding any foreign country is to go and see it. From the great number of American tourists that visit France each year, one may well be persuaded that France and America are destined to enjoy in coming years a sympathetic harmony of feeling based upon experience as well as tradition. I am sure we all wish that more French tourists came to the United States, and thus obtained a first-hand realization of the many peculiar problems with which our own country is faced. One must not, of course, expect too much of tourists. It is natural that Americans who visit France for a short stay, often confine

their researches mainly to the insides of French hotels and railway trains, and miss sight of many of the refinements of French cultural civilization. Tourists must not set too great store by superficial impressions. We Americans know that the European may have a considerable acquaintance with American-made cinemas, with their pictures of skyscrapers, cowboys, Indians and whatnot, and still understand very little about the character and spirit of our country.

One of the greatest services in the interests of closer mutual understanding between France and America has been performed by French writers. France sends each year comparatively few tourists and students to the United States, but those who do visit us have often been men of unusual discernment and range of intellectual comprehension. This has been true ever since De Tocqueville, whose description of America a century ago has been a classic ever since. That very eminent Ambassador, M. Jusserand, in his long and distinguished career in Washington, was also uniquely able to interpret the two great sister republics to each other. Recently, a similar service has been performed by that brilliant French scholar, Professor André Siegfried, in his sympathetic and keenly intelligent book "America Comes of Age." Professor Siegfried wisely and fairly dealt with our defects as well as our virtues, and avoided both superficial flattery and prejudiced criticism in his analysis of our national problems. Studies of this kind, realistic and yet impartial, are much needed in this modern world where international misunderstandings so easily develop. We Americans can well wish that we might produce a Siegfried of our own, to interpret to our own people with such clarity, justice and thoroughness the true spirit and civilization of France.

IV

No major economic event has during the past few years possessed a more genuine international significance than the splendid and astonishingly rapid financial recovery of France. I happened to be in Paris during that feverish and unhealthy July of 1926, when the entire French monetary situation seemed in a tragic and hopeless state of flux, and when confident predictions as to the inevitable and complete collapse of the franc were being made. The stabilization of this most dangerous situation was so suddenly and effectively accomplished that it compelled the admiration of the world. It was as if a second battle of Verdun had occurred, this time in the financial field, and that again the French people had resolutely declared, "They shall not pass!"

Today France finds herself with a gold supply which, if I am not mistaken, is second in size only to that of the United States, and indeed very nearly equal in per capita amount. France has had a great boom on the Bourse, as we have also had in America upon the New York Stock Exchange, and the best French securities today are very generally selling on even a lower yield basis than similar American securities. France has again become a great international lender, with extensive credits even in London and New York. This extraordinary financial achievement ranks even with the supreme accomplishments of France during the war itself. Difficult economic and financial problems of course still lie ahead, and I by no means wish to seem oblivious to them. Nevertheless, it is after all something besides mere American optimism that leads me, on the basis of what France already has accomplished in the way of financial recuperation, to foresee no insuperable obstacles in completing the latter and less difficult part of her financial programme.

I speak of this most gratifying financial recovery of France, because it has already made in an economic way for closer and more intimate relations with the United States. America in recent months has given an example to the world of avoiding a hoarding of gold for purely national reasons. Today in the United States, roughly 60 billion dollars of bank credit is supported by a base of about 4 billions of gold—in itself a remarkable achievement in the efficiency with which we have utilized gold in the creation of bank credit. The French franc and the American dollar are today both firmly established on the same basis of gold. Since the world's gold supply is after all relatively limited, the proper apportionment of it among the lending gold-standard nations, and the safe yet efficient employment of gold as a basis for the banking credit which commerce and industry require, remains as an international problem requiring our best efforts and our intelligent cooperation.

The return of more normal financial conditions here have also made France what she was before the war—a creditor nation, with funds to lend abroad. Presently French capital will seek extensive investment in long-term as well as in short-term forms. Here again lies another common bond with the United States. America, in engaging recently for practically the first time in foreign lending, has had no imperialistic aim. It has been an economic rather than a political development, caused by our sudden super-abundance of capital. The United States still has too great undeveloped resources within her own borders to need or desire to play an imperialistic role abroad on the basis of her exported capital. No such motive actually dominates today either Washington or Wall Street. On the other hand, American investors have no greater love of seeing their foreign investments impaired, than have the investors of any other modern country.

It is going to be more and more necessary in future years for the world's principal creditor nations—France and the United States of course among them—to cooperate as well as to compete in making foreign investments, and to establish standards for the export of capital which will sufficiently safeguard the investing classes of those countries. Too active competition among the leading creditor nations in making foreign loans can only result in the encouragement of unsound government and company finance for which the investor everywhere will ultimately be called upon to pay.

A final fundamental bond of understanding and sympathy between France and America lies in the very colonial problems which have so often created serious misunderstandings between the great powers. For many years the United States has striven to prepare its colonies for self-government, and the independent Republic of Cuba today symbolizes the unselfish spirit of our colonial policies. As all colonial powers have discovered, however, a certain economic and educational evolution is often required, before political independence can be truly called a blessing. The United States is striving today to extend the benefits of civilization in a just and humane way to her colonial possessions, and for this reason the unusual accomplishments of the French in their North African possessions have been widely admired in America. Undertaken in a spirit of intelligence and humanity, the French pacification of North Africa has been a genuine achievement in the extension of civilization itself. We Americans, to whom the great names of La Salle and Pere Marquette are still familiar, have long had an especial reason to congratulate France upon the continuing force and character of her colonial enterprises in the twentieth century.

V

Mr. President, you have had in the past many celebrated speakers before this American Club of Paris. Illustrious generals and eminent statesmen, great business executives and famous artists, have appeared before your members to further that great cause—the traditional friendship between France and America. By inviting me to address you here, it is not unlikely that you have honored the President of the New York Stock Exchange more than he has succeeded in doing justice to so exalted a cause.

Stock markets, however, are peculiarly sensitive and broad mirrors to the modern world in which we live, and those of us who happen to be closely associated with their administration over a period of years, obtain in certain respects a rather comprehensive schooling in economic realities. It has been with this background of experience that I have ventured tonight to speak of the future need of closer international understanding, and to mention a few of the stumbling blocks in the way of its achievement.

Complete and absolute international understanding is, after all, something very difficult to accomplish. So few modern nations always understand their own motives and attitudes, let alone those of other countries. It is highly probable that Frenchmen and Americans will for the most part always detect in each other, traits which are unfamiliar and even incomprehensible. Yet some critic has said of genuine affection that it always has an element of strangeness in it. It is likely that as long as France and the United States do not try to resemble each other too closely, they will get on famously together. Certainly the very differences of our two countries in age, in tradition and in our respective geographical spheres of influence, should prove a very sound basis for the continuance of that indissoluble friendship which has so long characterized our relations.

OLD AND NEW AMSTERDAM

Address at a Dinner of the Amsterdam Stock Exchange Committee, Amsterdam, Holland, February 26, 1929

OLD AND NEW AMSTERDAM

The United States of America, which unites the blood and traditions of so many races and peoples, has a particular historic obligation to the Netherlands. Especially is this true of New York City—today the commercial and financial metropolis of America—which was founded by the Dutch and in the first years of its existence was called New Amsterdam. The celebrated discoverer, Henry Hudson, sailing in behalf of the old Dutch West India Company, failed in his heroic attempt to discover a northwest passage to the Orient, but he did leave his name forever to the Hudson River which has been so important a factor in establishing New York's commercial supremacy in the western world. It was the Dutch explorers and traders who first saw the great natural advantages of New York as a center for trade. The modern financial district of New York City today stands upon the lower tip of Manhattan Island which the Dutch selected as the site of their original trading post. Wall Street in fact received its name from the wooden stockade or wall which was originally built across the lower end of Manhattan Island to protect the early colonists from the Indians.

The early Dutch settlement of New York, although it occurred about three centuries ago, has left a lasting impression upon New York City in more ways than one. Since the old Dutch patroons and commercial families were naturally the first New Yorkers to attain wealth and prestige, our social register still devotes much space to the Van Rensselaers and the Suydams, the Van Cortlandts and the Vanderbilts. The same thing is of course true of the place-names still used in New York—such as Harlem, Staten Island and the Bowery. I am told, in fact, that

many local expressions used in New York but not so generally in other parts of the United States, are derived from Dutch rather than English words, and thus still recall the days when Peter Stuyvesant and Wouter Van Twiller were the governors of the New York settlement. The modern New Yorker, when he visits Amsterdam itself, is therefore bound to feel an especial interest in the old country from which so many familiar features of his own city were originally derived.

II

I realize of course that in a brief visit it is very difficult, if not impossible, to gain any adequate understanding of a financial community as important and as old as Amsterdam. Nevertheless, an American is bound to get many very interesting impressions and ideas merely from a short stay here.

To anyone associated with the work of American finance, as I happen to be, the vast depth and range of financial Amsterdam's past experience with international economic and financial problems is particularly impressive. New York is, of course, a very large financial market, and has for many years carried out a vast aggregate of financial transactions involved in the building up of the United States. Indeed, this task is by no means completed as yet. As you know, the United States is still a largely undeveloped country, and probably for many years to come the great bulk of our savings and capital will continue to be invested within our own domains. The New York Stock Exchange is in consequence likely to interest itself chiefly in the creation of, and investment in, American bonds and shares.

Nevertheless, in recent years, evidence has not been lacking that the foundations of our great task of settling the United States and providing all parts of it with modern facilities for production and com-

munication, while still far from completed, have been firmly laid. Also, for the first time in our history, our prosperity has enabled us to generate capital and credit even in excess of our own enormous annual needs. As a result, the United States has recently found itself with funds to lend abroad, and has become an international creditor nation on a large scale. This naturally is an unprecedented situation in America, and probably marks the beginning of a new historical epoch in our national economic and financial development.

The transformation of the United States into a creditor nation has occurred so rapidly that it has produced a certain amount of bewilderment in the minds of many of our financial leaders as to the methods and technique proper under this new economic situation. It must be remembered that American financial customs and institutions have for over a century been developed under conditions when the United States was consistently a debtor nation. There has consequently been little conception in American finance of the possibility of possessing a surplus of capital over and above the demand for capital investment arising within the United States itself. For this reason, American financial men are becoming more and more interested in the way that the older financial creditor centers of Europe have handled such problems in the past. It seems likely that as time goes on, American financial methods will come more and more to resemble those long since devised by these older European creditor centers.

Normally, of course, the American who wishes to study the technique of a financial creditor nation, will first acquaint himself with British methods and with the great financial metropolis of London. In so doing, the difficulty of speaking and reading a different language scarcely exists, and the close resemblance of British and American law also facilitates such a course. But before the American gets very far in his studies

of British financial methods and history, he begins to realize that the British themselves at the end of the 17th century received a great deal of their financial education from the Dutch. Indeed, historians tell us that it was the expert Dutch financial advisors of William of Orange who, when he became King of England, did much in laying a proper foundation for the subsequent vast growth of London as a financial center. Even today the old Dutch Reformed Church stands in the heart of London City as a memorial to the early Dutch influence upon the surrounding financial center.

For this reason it is most interesting to the American student of finance to in turn trace the technique of British finance back to this old city of Amsterdam, which over three hundred years ago had become the leading financial market of the world. Here it was that central banking was first really organized, that bearer securities were developed, and that the first active stock exchange dealings in shares occurred. I realize that in the long history of Europe, three hundred years may not seem such an enormous space of time. Americans, however, remember that financial Amsterdam had begun to work out the numerous problems connected with acting as the leading international money market, at a time when the first permanent settlements by Europeans in the United States had barely begun, and before practically any of our great modern American cities were even founded.

It goes without saying that this long experience with financial problems which this old money center of Amsterdam has had, makes its precedents and its institutions of great interest to the younger countries of today. We Americans, particularly, should make every effort to avail ourselves of the long development of financial experience and technique which has occurred here.

Such a more intimate understanding of Dutch

finance is of course greatly assisted by the close association which Amsterdam and New York have recently had in the international financing which has followed the war. Your leading banking firms and ours have frequently been associated together in the issuance of new loans to many parts of the world. Our Stock Exchange price lists also show this close relationship during recent years. The bonds of the Kingdom of the Netherlands, as well as those of the Dutch East Indies and also the shares of the great Royal Dutch Oil Company, are listed and dealt in today upon the New York Stock Exchange. On the other hand, the official list of the Amsterdam Stock Exchange is inclined to make the American visitor here feel very much at home, for your admirable Stock Exchange has long permitted dealings in many of our best American railway securities and also such leading American industrial shares as U. S. Steel.

After all, such an interchange of securities between nations provides one of the best means to promote international understanding. Certainly one of the reasons why the bankers of Holland often have such an accurate knowledge of the United States has been due to the large amounts of American securities in which your investors have in the past placed their funds. In the same way, the appearance of Dutch securities on the New York Stock Exchange has done much to familiarize the American people with the progress and enterprise of the Netherlands today.

Amsterdam is of course significant not only as a financial center today, but also as one of the great commercial and distributing centers of the world. To the New Yorker it is particularly interesting to learn of the great range of products which pass daily through your splendid port and your great warehouses, and to realize that in large measure this extensive commerce carried on here represents the same interest in Oriental and tropical products which was begun so many years ago by the great Dutch navi-

gators who opened the way by water to the spice-producing regions of the East Indies. So old was this spice trade in Europe that, as you will recall, the Italian, Dutch and other explorers originally discovered America in an attempt to reach the Orient by sailing westward. That the market for these tropical products has during so many years remained in Amsterdam, is a great tribute to the industry, skilled knowledge, and world-wide marketing ability which your people have so long possessed.

The recent prosperity of the United States, and the high standard of living which this prosperity has produced, has enormously expanded the ability of Americans to consume many of these tropical products in which Amsterdam has so largely been interested. In diamonds, oil, tea, coffee, rubber and tin, American consumption is of course today a very important factor, and the trade which has accrued to the Dutch through the expansion of our American imports has to an increasing extent provided a closer link between Holland and the United States.

III

I cannot close without speaking of a final impression which I think all Americans who visit Holland obtain very vividly. Naturally, the geographical differences between Holland and the United States are very great. We have within our national borders the heart of an enormous continent, unusually rich in almost all those natural resources demanded by large-scale manufacturing and trade today. The American is therefore apt to presuppose the existence of such extensive natural resources in any leading commercial and financial country. For this reason, it is for us a very astonishing experience to visit a country as preeminent in industrial progress, commercial undertakings and international finance as the Netherlands, and realize to what a small extent

your position in the world can be attributed to the natural resources within the borders of your own land. In fact, your unique system of dykes and dams impresses the visitor here with the fact that a large part of your national area has actually had to be wrested by tireless industry and great engineering skill from the ocean itself.

Many times bankers are apt to over-estimate the importance of this matter of natural resources. Not so many years ago we were, for example, told that Russian Government bonds were bound to be a splendid investment because of the great undeveloped natural resources of that vast country. The subsequent experience of investors, both here and in my own country, has conclusively shown that thus far, at least, such a view was in reality a dangerous fallacy. It is necessary always to consider not merely the possession of great natural resources, but also the ability of their possessors to utilize them. Indeed, in the long run, I am persuaded that natural resources are in our modern world only a secondary advantage. Certainly that is the great lesson which the American visitor to Holland derives from his observation of the extraordinary commercial and financial accomplishments of this geographically small country, under circumstances so adverse that they would have broken the spirit and discouraged the enterprise of a less stout-hearted and less intelligent people. The Netherlands have truly for many centuries taken the whole world for the field of their commercial enterprise, and the preeminence in the arts of commerce and banking which the Dutch have long exhibited, has afforded an example and an inspiration to the younger nations of the world.

STOCK MARKET LOANS

Address at the Annual Dinner of the Chicago Stock Exchange, May 9, 1929

STOCK MARKET LOANS

It is always a pleasure for me to address the members of the Chicago Stock Exchange, and the representatives of the Chicago business community, and particularly so upon a matter which relates to both the financial centers of Chicago and New York as vitally as do stock market loans. During the past year, attention has more and more been centered upon these so-called "brokers' loans," and the part played by them in our national economy. It is perhaps only natural that much of the discussion upon this large and complicated subject has been based upon unjustified assumptions, partial knowledge and inadequate perspectives. Even among our supposed experts in financial matters, very wide divergencies of opinion have been manifested. Some apparently think that American business is sick with a speculative fever which demands immediate and drastic remedies. Others have taken the attitude that American business was never more healthy, and actually in no need of artificial remedies. Still others are readier to advocate strange drugs and novel potions than to state sound reasons for employing them. It therefore seems particularly necessary to obtain the basic facts concerning stock market loans without prejudice or illusion.

II

An initial difficulty in discussing brokers' loans, consists in the many fallacies concerning them which seem to have obtained wide currency. Such misconceptions are apt to obscure and pervert sound judgment at the very outset, and must first be cleared away before the subject can be discussed intelligently, accurately and constructively.

One of these fallacies concerning stock market loans is that they promote "gambling on the stock exchanges." I do not need to remind you that this is a most serious charge, since gambling transactions are practically illegal as such, and since settlement upon them cannot legally be enforced in the courts. If this assertion were true, very obviously our public authorities have been curiously remiss for over a century in not closing every stock exchange in the country. Actually, of course, there is no truthful foundation for this statement, and no well-informed person will repeat it unless his delight in using spectacular language wholly over-balances either his knowledge or his sense of the truth. Transactions on the New York Stock Exchange, and on all of the legitimate stock exchanges of the United States, consist of actual purchases and sales. All contracts made on such exchanges are enforceable at law, and contracts on the New York Stock Exchange are more quickly and thoroughly enforceable than upon any major stock exchange in the world. If the transactions on our stock exchanges are illegitimate, then by the same process of reasoning every purchase and sale throughout American business is also illegitimate. The phrase "gambling on the Stock Exchange," is therefore a mere abusive epithet without a shred of actual evidence to justify it. Brokers' loans do not promote gambling. Sometimes, indeed frequently, they subserve a speculative purpose. But speculation differs completely from gambling, not only under the law, but also in its economic character and function. Speculation on its part is a force which pervades every field of American business and economic enterprise. Sometimes critics of stock market loans, lacking other arguments against them, solemnly inform us that they finance speculation—as if practically every bank loan of any kind did not do precisely the same thing! I challenge anyone to point out to me a

single class of transactions in which any commercial bank in this country has ever engaged, that did not involve speculation. I furthermore challenge any business man in this country to point out any line of business activity which does not contain integral speculative factors. Merely in the interest of clear thinking, it is therefore high time that we ceased decrying speculation in securities and winking at it in everything else. If we cannot probe deeper into these economic questions than merely to bandy epithets, we will never solve any of them.

Another fallacy concerning brokers' loans, curiously enough, consists in the vague apprehension that they may prove dangerous to lenders. Here again no actual evidence to support this assumption can be found. For at least two generations, call loans made to Stock Exchange members on Stock Exchange collateral have proved the safest method of investing money known in this country. To say nothing of earlier occasions when the safety of stock market loans was put to the severest tests, I would remind you that in the deflationary period of 1919-1921, brokers' loans were deflated to the tremendous extent of over 60 per cent. without one lender losing so much as a single penny upon them. One can therefore with perfect confidence challenge those who criticize stock market loans on the score of their safety to lenders, to produce from the whole record of banking and investment in this country any other form of loan or investment with any such record as this. No one possessing any real experience with American finance will be inclined to question this statement. Moreover, these loans are today even safer than they have been in the past, due to the higher collateral margins demanded upon them, the extensive marking of security collateral beneath market prices, the magnificent showing by New York Stock Exchange members in the matter of insolvencies in the last few years, the high price of Stock

Exchange seats today, our questionnaire system of periodically examining our members' accounts, and many other structural improvements in the financial system which bear upon them.

"But," say some critics, "too many stock market loans are made on demand, and too few on time." Is it really a dangerous thing for the stock market to be so largely financed upon obligations repayable on demand? Again let us look at the record. Over the period of 1919-1921, call loans constituted the smallest percentage of stock market loans on October 1, 1919—on the very verge of the vast deflationary market of that time, while the highest percentage of call to total loans occurred on June 1, 1921—just as the stock market was preparing to turn upward after its severe deflation. I do not wish to assert that history always repeats itself. I merely wish to call your attention to the fact that the evidence as to the danger of a high proportion of call loans to total stock market loans is directly contradicted by such actual evidence as may be derived from the last great deflationary stock market which we have had.

Still other critics of stock market loans assert that they do not constitute "legitimate business." This particular phrase has recently been used over and over again in discussing the subject. Yet those who use it do not tell us exactly what legitimate business really consists of, or exactly on what grounds stock market loans fail to conform with such a definition. Actually, of course, stock market loans are entirely legitimate in their character. It has long been the business of bankers and other money lenders to furnish funds which enable business men to deal in all sorts of property. Practically all so-called "legitimate commercial loans" represent just such dealings in commodities, and I may add, primarily with a speculative motive. Just why are dealings in securities illegitimate, while dealings in any other

form of property constitute the basis of all business? It is thoroughly inconsistent to condemn the purchasing and selling of securities, and in the same breath to sanctify purchases and sales of every other form of property with the irreproachable term of "legitimate commercial transactions."

The claim is also occasionally made that funds invested in stock market loans are somehow withdrawn artificially from productive uses. Sometimes, indeed, quite eloquent writers picture the stock market as a vast and insatiable quicksand into which any amount of funds can sink without leaving a trace upon American industry and commerce. This view of stock market loans is also completely fallacious, and never should the fallacy have been more completely obvious than in the past few years. For the funds invested in stock market loans enable the speedy distribution of American securities, and the adequate financing of all types of American commercial and industrial enterprises. The fact that this distribution has recently occurred on a great scale should really be a cause for national enthusiasm rather than apprehension. It means that American business organizations as a whole are purchasing and installing adequate productive equipment, which has already shown its importance in our national system of economy by the constantly declining production costs which it has permitted. Our economists have had much to say during recent years concerning the astonishing ability of American industry to lower its production costs, and yet maintain high wage levels. Not so many of these gentlemen, however, have investigated behind this situation into the facilities for corporate financing made available to the nation through stock market loans. According to a recent survey, stock issues recently listed on the Exchange have provided many hundreds of millions of dollars as working capital to American corporations located all over this country; without stock

market loans these issues could never have been floated. It is therefore thoroughly absurd to rejoice in our present-day national industrial prosperity, and at the same time to bewail the size of the very stock market loans which have played so vital a part in financing it.

Some of our more erudite financial students criticize stock market loans because they do not, like "legitimate commercial loans," finance the shipment of goods in transit. It is of course an ancient tenet of commercial banking that the primary function of the commercial banker is to assure the easy flow of goods between different communities. I have no quarrel with this time-honored adage of the commercial banking business. So vital is the flow of goods, not merely to prosperity, but even to existence in a highly complicated modern nation, that no one should question the primary importance of loans which facilitate it. But on this score I would like to inquire just how many of the so-called "legitimate commercial loans" of American banks today are actually employed merely to finance the shipment of goods. If you will examine the portfolios of almost any American commercial bank, you will find that its loans not only finance the shipment of goods, but also the producers of those goods, and in recent years even the consumers of the same goods through "installment selling." You will also find that our commercial banks are holding enormous quantities of long-term security investments. Why is it then, that when our orthodox commercial banking theorists wish to criticize stock market loans, they can only compare them with loans which finance shipments, but always maintain a discreet silence concerning the wide range of so-called "commercial loans" which finance both producers and consumers, and also concerning our banks' bond investments? If we are to judge our commercial banking system by doctrinaire formulas, then at least let

us be sure that we apply these formulas to all modern banking loans and investments, and not simply to a single class of them.

Other critics of stock market loans seem to be primarily concerned over what they delight to call the "inflation" of the stock market. This introduces a highly interesting though complicated topic, and one which is naturally somewhat difficult for any one occupying my particular position to discuss. But the chief thing that I am interested in is to find out the grounds which these gentlemen have for so confidently stating that the stock market is inflated. Perhaps they possess some secret and mysterious knowledge on the subject which is hidden from me. But I have been very greatly impressed by the selective character of stock market prices over recent years. Some securities have appreciated enormously, while other securities have declined very greatly in price. The United States has become for the first time in its history a genuine creditor nation, with an actual surplus of funds available for investment. It is well known that in London, Paris, Amsterdam and other European financial creditor centers before the war, security price levels were naturally high and yields on securities were naturally low, as compared with the debtor nations where the demand for capital steadily exceeded the supply of capital. In consequence, the American stock market seems to me inevitably to reflect conditions of supply and demand in respect to capital. I question those who so confidently declare that our share prices are today "inflated." I want to see the actual evidence on which they base such assertions before I will agree with them. During a recent visit to Paris I noted with great interest that since France has again become a creditor nation, French share prices have appreciated even more rapidly than have American share prices, and the yields on French securities have fallen much lower than even present yields on com-

parable American securities. Before we make cocksure judgments about whether the New York stock market is inflated, I think we must give due consideration to these and similar factors.

Speaking of stock market inflation, I would also call your attention to the fact that prices of securities on the New York Stock Exchange are not made by some little group of men sitting off in some hidden corner somewhere. The prices of our listed securities are actually made in a free and open market by purchasers and sellers in all parts of this country, and from many foreign lands. By and large, this vast modern investing public expresses in current stock market prices, a collective judgment as to security values which is regularly superior to the judgment of any single individual. I am always a little skeptical about individuals who claim to know more than the whole stock market, just as I am skeptical concerning persons who in their vanity declare that their individual opinions are correct and that the whole world is wrong. Inexperience, a love of publicity, and no small amount of vanity have probably prompted many of these wise counsellors to discourse upon the unreasonableness of American security prices today. I am not myself quite so quick in assuming that the entire public of this country has suddenly become lunatics.

A final fallacy concerning the stock market is that prices of its listed securities can move in either direction forever, and that therefore we must every now and then call in some of our best minds to correct its vagaries. Actually the stock market of itself possesses a very complete ability to correct its own mistakes. When prices rise and the floating supply of securities in the market rises, sooner or later the load becomes top-heavy and prices decline. Similarly, when prices decline along with the floating supply of securities in the market, sooner or later buoyancy is reattained and prices move upward

again. This process, which is only an applied form of the old principle of supply and demand, has gone on regularly in the stock market, and also in other markets, for many years, and if left alone can be depended upon to do so for many more. Artificial attempts to control and regulate the movement of market prices inevitably fail, because they pervert and interfere with this normal economic procedure. However irrational or incorrect our stock market prices may have seemed over the past few years, I would like to ask if they have not all along been in closer accord with the swiftly developing economic realities of our national prosperity than the predictions of most of our leading economists, students, and financial experts. Some one has said that "everyone is greater than anyone." This old adage quite adequately, it seems to me, explains why we must be a little cautious about believing all the confident assertions concerning the incorrectness of stock market prices, and their inflationary character, which certain critics seem to delight in making.

III

Turning from the purely negative consideration of what stock market loans most emphatically are not, it is worth while to consider briefly the actual nature of their functions. Adequate knowledge on this score is obviously imperative before we can decide out of hand that stock market loans should be abolished, or restricted, or artificially interfered with.

In the first place, it is well to recognize that the function of the stock market in rendering liquid and negotiable its vast panorama of listed securities necessarily involves the use of funds loaned on security collateral. On January 1st of this year the total market value of securities listed on the New York Stock Exchange aggregated over 114

billions of dollars. This colossal sum constitutes a large proportion of our total national wealth. The fact that any part of this vast mass of listed securities can be readily purchased and sold at any time on the Stock Exchange is a factor of enormous importance in every sphere of American business enterprise. This was conclusively proved in the fall of 1914, when the New York Stock Exchange was compelled to suspend its operations for several months. To hamper artificially the lending of money on stock market collateral consequently decreases the liquidity of wealth and property throughout this and other countries.

Stock market loans also perform a regular and vitally important function in facilitating the gradual distribution of securities from their issuers to the American investing class. Practically always, new securities in considerable amounts cannot be sold in their entirety to outright holders. It is therefore necessary, particularly in the early stages of distribution, to have facilities for carrying them on borrowed money until sufficient outright investors' demand develops to absorb them. ¶ Even with our Liberty Bond issues during the recent war period, it proved absolutely imperative to provide funds to carry unsold bonds gradually into distribution. With American company shares, this process of distribution is often a slow one. The United States Steel Corporation, for example, has during the twenty-eight years of its history so far succeeded in distributing only about 85 per cent. of its common stock to outright investors, while in the early years of the Corporation there were times when much less than half of "Steel common" was held by outright investors. But meanwhile the Steel Corporation had obtained its capital, and could steadily utilize it in its operations. Many other great American companies, of course, have obtained capital through the securities market for the prosecution of their

business in precisely the same way. In consequence there is a direct relationship between the facilities for making stock market loans and the enjoyment of continuous industrial progress. Any arbitrary curtailment of funds for stock market loans inevitably acts as a curb upon progress and prosperity, since it hinders our business companies from readily obtaining capital which their continual development necessitates.

A further and frequently overlooked function of stock market loans consists in the safe outlet for surplus capital and credit which they provide. People sometimes forget that it may be almost as embarrassing to have too much capital and credit as it is to have too little. It is consequently of enormous importance to the entire country to have in its major stock market a mechanism for absorbing surplus capital and credit, and for making this again available in case of need. Without the flexible reservoir for capital and credit thus provided by the stock market and by stock market loans, surplus capital and credit would continually force their way into needless commodity or real estate dealings, attended by rising commodity prices, the withholding from the market of large traders' inventories, and a development of business inflation which could only end in a crash. Such inflation of commodities and real estate would affect all business, all profits and wages, and our entire national standards of living.

During recent years the fact has often been noticed that despite our great prosperity and our enormously expanded national income, commodity prices have remained comparatively stable, and traders' inventories of commodities and goods have remained very light. This desirable condition in American business, which has been so basic to our continued prosperity, could not have been maintained had not the call loan market and stock market loans provided a safe and useful outlet for our surplus

funds. This condition remains today. If our stock market loans were artificially deflated today, we would still be faced with the highly important problem of what to do with the additional funds thereby obtained. The example of 1919-1920 should still remind us of the great hazards to business entailed by pumping needless banking funds into commodity inflation. I have never yet heard any of the advocates of deflating stock market loans explain clearly just what they would do with the funds to be obtained by this course of action. I believe that if clumsy and misguided attempts to deflate stock market loans were carried to their logical conclusion, there might be great danger of inaugurating an era of commodity inflation which would present the gravest dangers to our business prosperity.

A final significant function of stock market loans on call consists in their great usefulness to American commercial banks as safe and liquid investments. The day was when these loans constituted the actual secondary reserve of all American commercial banks. The inauguration of the Federal Reserve system greatly lightened the load thus imposed upon the call loan market and sometimes upon the stock market itself, by providing a flexible system for rediscounting commercial loans. But it must be remembered that there are still thousands of commercial banks in this country which are not members of the Federal Reserve system and which look to call loans to preserve their liquidity, and in adverse circumstances their very solvency. Furthermore, even member banks of the Federal Reserve system found in 1920 that call loans were actually the most liquid and available loans which they possessed. Any undue curtailment of stock market loans therefore entails distinct dangers to the solvency of American banks themselves. If more of our commercial banks in this country had invested more heavily in call loans, we would not have experienced

the huge number of banking insolvencies which we actually have had during the past five years. In the course of the deflation of real estate in Florida, the banks in that state which during the crisis proved bulwarks of strength to the whole community there by paying out deposits over their counters on demand, were the very institutions which had previously invested the largest proportion of their resources in call loans. Artificial interference or special persecution of stock market loans cannot be lightly undertaken by anyone, since these loans play a vital part in maintaining the liquidity of commercial banks throughout this country.

IV

Thus far I have exposed certain common fallacies concerning stock market loans, and have pointed out a few of their more important actual economic functions. Like every other species of useful loan, however, it is possible sometimes to have either too many of them, or too few of them. I confess that I do not know any absolute standard by which to judge whether or not brokers' loans are too large, and I can only say in this regard that I have not heard anyone else yet provide any such definite standard.

It is naturally important to measure our present stock market loan account as accurately as possible and in complete perspective. But in doing this, we should go further than merely drawing a chart of total brokers' loans and watching the line representing their total climb up during recent years. There is of course no reason to be frightened at statistics merely because they involve large numbers. Many figures in regard to American business run into the billions. The market value of listed securities on the Stock Exchange is at present over 114 billions. Total resources of American banks today are about 60

billions of dollars, and our national wealth can only be measured today by hundreds of billions of dollars. We must therefore consider brokers' loans statistics not simply by themselves, but in relation to the other gigantic total statistical figures relating to American business and finance.

I wish first to comment briefly on the real factors behind the demand for stock market loans. The securities listed on the New York Stock Exchange which provide the bulk of the security collateral behind brokers' loans, have recently experienced a great expansion. During the years 1925-1928, the market value of all securities listed on the New York Stock Exchange increased approximately 54 billions of dollars, of which 21 billion dollars occurred in shares. Over these four years, the total number of shares listed on the New York Stock Exchange shows an increase from slightly under 500 million shares to slightly over 750 million shares—or more than 50 per cent. Very naturally this greater aggregate amount of securities listed on the New York Stock Exchange has called for larger sums of money to carry them into permanent distribution. Apparently all that some financial students have been able to see in this vast growth of American marketable securities is what they term "inflation." It is, I may say parenthetically, always a very convenient way of avoiding thought on these subjects, to apply to them such vague words as "inflation" or "speculation," without halting to define what such terms mean. Actually the increase in listings has been due to many perfectly distinct and highly significant recent trends in American economic affairs. Obviously our great national prosperity, with the increased corporate earnings and enhanced corporate assets which it has gradually built up, has necessitated a great growth in size and value of American business equities. In addition, many small companies have recently grown to such size that their security issues

have naturally sought the facilities of the organized security markets for the first time. Former partnerships have also converted themselves into stock corporations and listed their securities on the exchanges. Furthermore, the great centralizing tendency in American business has tended to consolidate many small enterprises and companies into large units, whose financing necessitates recourse to our national stock market. Shares in American corporations have also been issued to enable our American companies to acquire vast foreign assets, and in addition a great volume of foreign securities has been directly introduced into the market. American corporations have also taken very extensively to financing themselves by selling new issues of securities to the public through the stock markets, in preference to their former habit of contracting commercial loans at the banks. One cannot merely wave his hand at these and many other kindred economic developments in American business during the past few years, and call it "inflation" or "speculation."

A second cause behind the increased demand for stock market loans obviously consists in rising security prices. Measured by stock averages or stock indices based on only a few issues, the appreciation of American share prices has sometimes been made to seem prodigious, and it is largely upon such superficial and fallacious evidence that so many people have concluded that share prices were "inflated." But, as I have already pointed out, when all listed stock issues are taken as a basis, it will be found that the average share listed on the New York Stock Exchange appreciated in price about 18 per cent. during 1928, and over the years 1925-1928 about 66 per cent. Meanwhile it has been apparent that not all share issues have appreciated to an equal extent, while some shares have experienced a very considerable decline in price. The stock market has given many evidences

in recent years of being a very selective one. America has become a creditor nation and, like older creditor nations of Europe, will probably have to accustom itself to a lower yield on securities than was available when we were a debtor nation. It is therefore an open question whether it is quite accurate to designate the recent inevitable rise in share prices as an "orgy of inflation," or a "speculative mania." It may well be that in this respect the collective stock market, representing the opinions of our whole security investing class, will prove wiser than those who are today employing these lurid phrases.

A third cause for the increased demand for stock market loans consists in the proportionate size of the stock market "floating supply"—or in other words, the amount of outstanding listed securities still unsold to outright investors. Such evidence on this point as exists tends to show that this proportion of unsold securities increased somewhat during 1928, without at any time reaching the high proportions which existed before the break in the stock market in March, 1926. This factor, however, naturally relates to the internal process of readjustment constantly occurring within the stock market, whereby excesses in the proportionate size of the "floating supply" have in the past always brought about their own cure.

Finally, it has been often pointed out that stock market loans are not based solely on the collateral of the securities listed on the New York Stock Exchange. The growth in New York Stock Exchange listings has not occurred as an isolated phenomenon in the American security business, other branches and divisions of which have shown similar expansion. All over the United States our American stock exchanges large and small have grown very greatly during recent years. In New York, the Curb Market Association has evolved as the second largest stock exchange in this country. Your own

Chicago Stock Exchange has of course expanded remarkably. The over-the-counter business in securities, both domestic and foreign, has enormously increased. Finally there has occurred a similar expansion in the flotation of new security issues. In all these other branches of the security business, no less than in the New York Stock Exchange, continual recent expansion has inevitably called for larger sums of money to carry security issues into distribution.

Our great national prosperity in recent years is not yet thoroughly understood. No nation in all history has ever experienced quite the same sort of thing. Few if any of us have as yet satisfactorily analyzed its basic causes. That it has been accompanied by an enormous expansion in our facilities for production, and that the financing of these expanded productive facilities has been largely accomplished by increased issues of securities, seems self-evident. With the longer perspective which future years will provide, we may well come to realize that there is an integral relationship between national prosperity and activity in the security business, and that to artificially hamper or interfere with the latter is inevitably to imperil the former.

V

The principal source of controversy in regard to stock market loans has centered around the question as to the supply of funds employed in them. Before plunging into this extensive subject, it seems well to get a brief bird's-eye view of American banking as a whole. The last Report of the Comptroller of the Currency as of June 30, 1928 showed that the total resources of all our national, state, commercial, and private banks, together with those of our loan and trust companies, aggregated slightly over 60 billion dollars. Unfortunately, loans on securities are not

clearly shown in its compilations, but at the utmost they did not aggregate over 6¾ billions, or about 11 per cent. Meanwhile other loans and discounts aggregated over 26 billions (or about 43 per cent.), and security investments over 14½ billions (or about 25 per cent.).

If there has developed a dangerous shortage of funds in our banking system, how can this system afford to make long-term fixed investments of 14½ billions of dollars, or approximately 25 per cent. of its total resources? Why was such an accumulation of bond holdings, upon which banks can take and frequently have taken severe losses, allowed to occur? Does experience show that bond holdings of commercial banks are as safe and liquid as are stock market loans? Is their economic function more important, and if so, why? Moreover, the resources of our banks today include vast credits to producers, loans on real estate, installment credits and other forms of commercial lending beside the financing of goods in transit. If our banking system has been expanding too rapidly, why have we heard no criticism of these very extensive types of bank loans and investments? Why have stock market loans been especially discriminated against and singled out for persecution?

Fears are sometimes expressed concerning our gold supply. If our central bank system is in danger of exhausting its gold supply, certainly its statement does not show it. The ratio of the Federal Reserve system today stands at approximately 70 per cent., with additional hidden gold assets sterilized in the form of gold certificates. Obviously, our banking system still possesses vast reservoirs of potential credit. Why is this credit being so rigidly hoarded?

In attempting to justify the rigid restriction of American credit, no one can well declare that there is any parallel between American banking conditions today and those which existed in the spring of 1920.

This will be clearly brought out by comparing the Federal Reserve statements for February 27th, 1920 and for February 27th, 1929. As between these two dates, Federal Reserve notes outstanding have declined more than 1,600 million dollars, deposits have declined almost 500 million dollars, and total liabilities have declined almost 1,250 million dollars. At the same time, Federal Reserve rediscounts have fallen about 1,500 million dollars, bills bought in the open market have declined almost 200 million, and Government securities held have declined slightly over 125 million, or a decline for all Federal Reserve rediscounts and investments of over 1,800 millions. At the same time, total Reserve gold holdings have increased over 700 million dollars, and the Federal Reserve ratio has risen from a little over 40 per cent. to over 70 per cent. The only similarity between these periods seems to consist in the restriction on credit revealed by interest rates. Nine years ago, the rediscount rate was 6 per cent. against 5 per cent. today. In the first quarter of 1920, the high rate for call funds was 25 per cent. as against 20 per cent. this year, but the high rate for time funds was 8½ per cent. this year against 8 per cent. nine years ago.

To many of us it is therefore still a deep mystery why there is any such pressing necessity to deflate security loans today. It cannot be that the Federal Reserve system has decided that security prices are too high, and that it therefore proposes to bring them down if necessary with a crash, for the spokesmen of the Reserve have frequently disclaimed any motive of this sort. Has the Federal Reserve system embarked on a doctrinaire policy of limiting security speculation as such? Or how should the recent Reserve statements concerning speculation be interpreted? These are some of the questions inevitably forced upon the business and financial public today by the actions of the Federal Reserve system over the past twelve months. Apparently in the begin-

ning, the central purpose of the Federal Reserve system in its tight money policy was to reduce the total amount of stock market loans, although the grounds for deciding on this policy are by no means clear to us. But it must be obvious by this time that the methods chosen to accomplish it have failed. Since the spring of 1928, stock market loans, instead of decreasing, have risen considerably. It is therefore time that we asked ourselves whether this alleged remedy for an alleged disease is or can be really efficacious, and whether we had not better attempt a new and realistic diagnosis of the actual banking aspect of stock market loans.

The reason why the Federal Reserve policy of tight money has failed is readily apparent on examination of the Federal Reserve weekly loan statistics. In the Reserve compilation, stock market loans come from three main sources: from New York banks, from out-of-town banks and from "other lenders." Now during the past year, the funds of New York banks employed in stock market loans have fallen slightly, while the funds of out-of-town banks in the loans have risen somewhat. The funds from both types of banks in these loans, taken together, show only a slight increase. It is in the third category—that of loans from "other lenders"—that the great increase has come, for this class of funds has risen over 1½ billion dollars over the past twelve months. These statistics over the past year also show that funds from New York banks could under Federal Reserve pressure be quite readily reduced, and that funds from out-of-town banks could similarly be reduced, although to a lesser extent, but that loans from "other lenders" have not only been impervious to the repeated pressure from the Federal Reserve system, but have instead risen continually as greater and greater pressure was put by the Reserve upon the money market. Obviously, the crux of the whole question resides in these loans by "other lenders."

It is of basic importance to realize that the first two classes of funds—namely, those from New York banks and from out-of-town banks—represent in the main *credit* which these banks manufacture by their lending power. Since a bank can, under of course certain restrictions, manufacture and lend such credit or not as it wishes, these funds are susceptible to the same kind of money market pressure and central banking policy as any other form of banking credit. The statistics of the past year indicate this fact quite clearly.

But the loans by "other lenders"—and this is the really important point—are to a large extent not *credit* manufactured by banks, but rather *capital* saved by individuals and business firms—a wholly different matter. As a result, a money market technique devised for the control of credit does not and can not apply with equal force to loans which represent capital savings. No one questions the jurisdiction of our banking authorities over the use of bank credit in stock market or any other loans, however much one may question their judgment in particular cases. But it is an open question whether their jurisdiction equally extends, or can be made to extend, to the flow of capital. Certainly there is no clear indication in the Federal Reserve Act that Federal Reserve authorities are expected to dictate as to how the individuals and business enterprises of the country should invest their own capital, nor is adequate machinery provided in our banking system for any such effort. Thus far, at least, the concrete results of the high money policy of the Federal Reserve system give us no reason to believe that the Federal Reserve authorities have clearly grasped the real nature of their attempt to dictate the flow of capital in this case.

VI

As I have already stated, it is highly doubtful whether American business today is really sick at all, and therefore whether any particular remedy for stock market loans or anything else is really needed. American business as a whole seems in superb condition, judged by all reliable economic indices except perhaps that of the high money rates which the Reserve system has elected to inaugurate. Except through the bond market, our enterprises are being adequately financed. Our commodity prices are stable, and mercantile inventories are low. Business turnover is rapid, and profits are good. This statement is merely a clear recognition of obvious past and present facts.

No claim concerning inflation is being made except in respect to the stock market. Yet even those who think the stock market inflated, whether openly or secretly, do not tell us clearly or adequately the basis for this opinion. Stock market inflation cannot be merely assumed without broad and careful analysis. There also remains the question of whose business it is to cure stock market inflation, granted that we do have it. Has the Federal Reserve system assumed this responsibility? We are not told.

But since the air is full of proposed remedies, it is necessary to consider some of these critically, lest we drift aimlessly and unintelligently with our present banking policies into a really unhealthy business condition.

First let us consider the remedy proposed and already attempted for a year by the Federal Reserve authorities. Eliminating other possible motives of action on their part, let us examine only their admitted effort to reduce stock market loans. Last spring the Federal Reserve system began to put severe pressure on the money market by practically every means at their control. This

policy has been with fair consistency maintained ever since. As a result, stock market loans are about 1½ billion dollars higher today than they were one year ago. If the whole aim of Reserve policy was to reduce stock market loans, then obviously the methods which they have employed have failed. This raises the question as to whether they should continue indefinitely to use methods which have proved unsuccessful, or whether they should devise some new method—and if so what.

It is important that the real solution of this problem be arrived at as speedily as possible, since the bad effects of the Reserve policy of tightening credit have become clearly apparent. The bond market has been crippled, and banks in this country with holdings of 14½ billion dollars of bonds have been seriously hindered in attempting to dispose of them. A higher cost for credit has been imposed on American industry, agriculture and commerce. Vague fear and lack of confidence have been injected into the security business. A rise has been caused in central bank rates and open market money rates abroad, with a weakness in certain foreign exchanges. Even the American bill business—that especial favorite of Federal Reserve policy—has been seriously disturbed. It may be that still more serious danger to American business looms ahead, if this policy of high money is persisted in.

The reason why the Reserve policy of tight money has failed to reduce stock market loans is, as I suggested a moment ago, because the funds employed in these loans are today to so large an extent capital, and not mere bank credit. When one clearly realizes this, one can understand just what has happened with stock market loans over the past year. The more fear propaganda, warnings and vague threats the Federal Reserve system has issued, naturally the more it has impelled owners of capital to place their funds in the safest form of loan which they could ob-

tain. Stock market call loans are without question the safest form of investment known in this country. As a result, fresh capital has been continually driven into call loans, little as the Federal Reserve authorities apparently have wished this to happen. Normally a capitalist might put his capital into stocks or bonds, but under continual vague warnings from our highest bank authorities, he can scarcely be blamed for lacking confidence in the stock market and for choosing call loans as an investment. In addition, the tight money policies of the Federal Reserve have succeeded in raising interest rates on call loans to exaggerated levels, far above the yield on any class of securities in our market. This policy again has only inclined the owner of capital to invest his money where it will bring the higher return. As a result, security loans from "other lenders" have continued to mount, due to the very policy which the Federal Reserve system has mistakenly been pursuing. We have not been told precisely what the Federal Reserve authorities have thought about all of this. I do not wish to accuse them of persisting in a mistaken policy merely out of stubbornness of opinion. I would only remind them that despite the great powers over credit vested in the administration of the Reserve system under the law, and despite the even greater power which in some respects they have indirectly assumed, as long as American prosperity continues they are in this matter facing the even more powerful factor of the economic law of supply and demand in respect to American capital. It is not the Stock Exchange, or the stock market, or even "stock market speculators" who are opposing the Federal Reserve system policy—it is the continual generation of fresh American capital upon an absolutely unprecedented scale, and the inevitable tendency under present Federal Reserve policies for this capital to seek investment in the very call stock market

loans which the Reserve is apparently desirous of deflating.

There is of course a possible way of reducing stock market loans even though these contain so much capital, and that is by bringing on a widespread business depression in this country. Capital, as I have said, does not contract and expand at the will of a banking policy in the same way that bank credit does. Capital can, however, be destroyed outright by a serious depression in business. The conscientious officers of the Federal Reserve system are of course as little desirous as anyone else of seeing this possibility realized in fact. Indeed, I am inclined to think that American business is too fundamentally healthy today to be thrown into any very serious depression, almost regardless of whatever bank policies might be adopted. Had serious weaknesses existed in the foundations of our national prosperity, it is inconceivable to me that a year of artificial high money rates would not already have revealed them. We may therefore assume that the conceivable remedy of reducing stock market loans by bringing on a business depression is obnoxious to everyone, and is entirely unlikely to happen.

There then remains another possibility—to divert the enormous masses of capital today invested in stock market loans, into some other form of investment. If the owners of this capital can be persuaded to seek some other form of investment for it, inevitably they will of their own accord remove it from call loans and put it into something else. But the question then arises into what could the capital at present invested in call loans be so diverted. This seems to me a highly important point. The United States today actually has more available capital than it knows what to do with. This is the reason why capital in call loans has risen to such large proportions and to such enormous amounts. Suppose we wished to deflate call market loans by—

say—two billions of dollars. What is there in the United States right at this minute into which two billions of dollars could be productively and safely invested? Almost everyone would agree that the artificial injection of any such sum of money as this into commercial business could only end in a huge rise in commodity prices, inflation of inventories, and an artificial business boom like that of 1919 based on commercial speculation, which could only end in a colossal smash. Ultimately, of course, two billions of dollars, and indeed many times this sum, can be and will be productively invested in this country in commercial operations, in real estate and other investments. But right at this minute the only place where such a sum of money, to be obtained by deflating stock market loans, could possibly go is into securities themselves. This is altogether natural, because the security market is by its nature a market for surplus capital and credit. The practical way, therefore, to reduce stock market loans is to induce the owners of capital invested in them to buy outright the collateral securities employed at present to secure their loans. If such a deflation occurs gradually, this does not entail any radical deflation of the levels of security prices. Stock market loans would sink, but the capital withdrawn from them would support the market by passing into securities themselves.

But, as I have already suggested, you cannot get the owner of capital in the form of a call loan to prefer an investment of his funds in securities outright, as long as disturbing threats continually produce uncertainty and uneasiness. What we need in our security market is understanding. To the same end it is equally necessary that the interest rate on call loans be reduced, so as not to offer to the owners of capital the present preferential income return over that offered by securities themselves. A lower level of interest

rates should also serve to revive the American bond market, to permit more easily the normal continuance of bond financing, and perhaps to enable our commercial banks the more easily to liquidate some of the 14½ billions of dollars which they at present hold in bond investments.

If capital is to be prevented or hindered from flowing into stock market loans, it may be that some obstacle could be placed in the way of capital entering bank deposits. This, however, opens many complicated questions in modern commercial banking upon which I do not feel altogether competent to express an opinion. But it must be obvious that capital is entering our banks very freely today, and thereby changing their ordinary status and technique. As of January 2nd this year, total member banks of the Reserve system possessed deposits of 21.0 billions of dollars, of which 13.9 were demand and 6.9 were time deposits. Obviously the time deposits were almost all capital rather than credit, and in addition probably a considerable proportion of the demand deposits were also. The effect of this entry of capital into our banking system is seen in the accompanying figures of loans and investments. On January 2nd, 1929 the member banks of the Reserve system showed total loans and investments of 22.7 billions, of which 9.0 billions were in so-called commercial loans (including, of course, loans to producers, distributors and consumers), 7.8 billions were in loans on securities, and 5.9 billions were in security investments themselves. Thus out of 22.7 billions total loans and investments, there were 12.7 billions (or over 55 per cent.) in securities or loans on securities, and less than 45 per cent. in the so-called commercial loans. It therefore might be asked whether our commercial banks today have not expanded their function to include the handling and investment of capital as such, instead of adhering to the strictly orthodox conception of commercial banking. It of

course lies within the province of Congress to raise the reserve requirements for time deposits, and this may seem a desirable step. Certainly if the entry of capital into our bank deposits, with the consequent expansion of security investments and loans on securities, is a dangerous tendency in modern American banking, this danger should be cured at the source. But I believe myself that any such step should be taken, if at all, only after very careful reflection. I am not inclined to think that action along this line would constitute any cure-all for alleged deficiencies in our banking system, which after all may not actually be deficiencies at all. The figures which I have cited, however, should instil a little caution into those critics of stock market loans who can see in them nothing sound or beneficial. Under the circumstances which the above statistics reveal, it is difficult to comprehend how the banks of this country could help having large loans on securities or large security investments.

In part, the difficulty which the Reserve system experiences in regard to stock market loans arises from the prohibition contained in the Federal Reserve Act against rediscounting them. The original theory of Federal Reserve rediscounting was that it should be confined purely to commercial loans and that it would work almost automatically. With the coming of the war, however, Reserve banks were empowered to invest directly in U. S. Government bonds and also to lend money upon them. These so-called "war powers," although quite contrary to the original theory of the Reserve Act, nevertheless gave the system flexibility and practical ease of operation. It was in accord with foreign central banking practices, and assisted in avoiding the practical difficulties entailed in rediscounting small and varied commercial instruments. In recent years, owing to the economic revolution through which American business and finance have been going, there has oc-

curred a remarkable shrinkage in the loans eligible for rediscount. Our Federal government has been reducing our national debt at the rate of roughly a billion dollars a year, and if this process continues, in some fifteen years there may remain no Federal securities for the Reserve banks to purchase or lend upon. Furthermore, commercial paper of the open-market type particularly eligible for rediscount has been shrinking greatly, in proportion as business companies in this country have obtained their funds from the securities market rather than from borrowing at the banks. The Federal Reserve consequently faces in the future a situation where extensive rediscounting may prove very difficult because of a lack of rediscountable loans. Obviously under such circumstances, the value of the Federal Reserve system to American business would decline in proportion. Inevitably the time is coming, therefore, when if only for the good of the Federal Reserve system itself, the rediscounting of security collateral loans should be undertaken.

Many fear that such a step would involve the extensive use of Federal Reserve credit in the stock market. But there probably is much Federal Reserve credit in stock market loans today, and under the present system the Federal Reserve cannot prevent it. Indeed, it is likely that if a careful and conservative system of rediscounting security loans could be evolved, less Reserve credit would get into the stock market than has already done so without such a rediscount privilege. Neither do I believe that rediscounting security loans would necessarily lead to inflation. I may point out that no one desires inflation in the stock market less than the New York Stock Exchange itself, because the inevitable following deflation must be borne primarily by members of the Exchange and their customers; in 1919-1921, for example, stock market loans were deflated over 60 per cent. without the loss of a penny to any

lender, but the losses to members of the Exchange and their customers are still recalled. If security loans were to be rediscounted at the Reserve banks, their rediscount rate could be maintained above the market rate, and both these rates above the similar rates for commercial loans. This system has been successfully employed by the Bank of England for many years, and there seems to be little evidence that in London it has caused inflation. The Bank of England is not alone in permitting the rediscount of security collateral loans other than on government securities—under varying conditions, the same practice is permitted by the Banque de France, and in Berlin by the Reichsbank. The Federal Reserve system is therefore the exception rather than the rule among central rediscounting banks, in especially barring security loans.

Such an ability to rediscount stock market loans would enable the Reserve system to obviate the recent ridiculously uneven rates in the call loan market. Rates of 15 or 20 per cent. on the soundest banking loans in this country are clearly an absurdity which could readily be prevented by permitting the Reserve banks to maintain closer contact with the market for security loans. As a general thing, the Federal Reserve system deserves very great credit in the work it has done in stabilizing American interest rates as a whole, despite recent vagaries in this regard. I believe that it can go even further in this useful direction, if it is given the necessary tools to work with in the shape of liberal and sound discount powers.

A final consideration in connection with remedies for the stock market loan situation is in connection with publicity concerning Reserve policies. Recently some who have had misgivings as to the wisdom of Federal Reserve actions have proposed new and rigid restrictions upon the authorities of the Reserve, in order to curb their freedom of action

and limit the scope of their activities. Some critics of the Reserve system seem indeed to have in mind a sort of automatic machine which would be bound to do the correct thing on every occasion, if only the proper legal restrictions were established for it.

I do not believe in this sort of thing at all. The Federal Reserve system must have a relatively free as well as an able management. No banking system can be expected to run itself automatically. Indeed I am convinced that some defects in Federal Reserve policy and operations today are basically due to efforts made in the past to hamper and restrict it. I favor giving very wide power to the system, and removing from its managers minute legal restrictions as to just how they shall perform the details of their business, or doctrinaire economic policies which they must carry out. I also view the policy of frequently underpaying both the officers and the employees of the Federal Reserve system as a fatal mistake. American currency and credit are of too great importance to everyone, for us to expect that they can be adequately administered either by a brainless automatic mechanism, or a battalion of purely clerical minds. If our Federal Reserve system is to obtain the best banking brains of the country, it must be allowed adequately to pay for them.

On the other hand, the responsibility of specific officers of the Reserve system for its actions should be plainly and clearly assumed, so that if its administrators prove incompetent, they can be replaced by others capable of doing the work. This is after all only the principle which guides any well-run business enterprise in this country. In particular, we need to be very much more definitely and clearly informed in regard to Federal Reserve policies, and the basis for them. By such publicity, I do not mean mere press-agenting, or namby-pamby

educational propaganda, but rather clear, frank and detailed statements upon Reserve policies, and the basis for their adoption. Much has already been done in this direction, but I believe that very much more still remains to be done. Unfortunately, yet inevitably, the nature and basis of Federal Reserve policy today remain very largely a mystery, not merely to those completely unacquainted with American finance, but even to bankers, security dealers, and others directly engaged in financial work. Uncertainty as to what the Federal Reserve may attempt to do next, has actually given rise to much financial speculation, since all speculation represents only an inevitable attempt to deal with the unknown. A more complete policy of publicity could, I believe, largely remedy this undesirable mystery which now surrounds Federal Reserve policy. The Federal Reserve system should possess the thorough confidence of everyone in the country, and merely on the record of its past accomplishments, the Reserve system has generally deserved such confidence. Secretiveness, however, is inevitably the parent of confusion, fear and suspicion.

VII

In the last few years much has been said and written concerning American prosperity. We have come to realize that this prosperity was not consciously brought about by anyone—that in a sense it was a lucky accident. Yet since we wish it to continue, we must make every effort thoroughly to understand it. It seems unlikely that prosperity can be maintained by employing obsolete or fallacious theories of banking, or inexpert bank practices.

People are generally recognizing that the United States today is going through a vast economic revolution, caused primarily by the momentous transformation of this country from a debtor to a creditor

nation. None of us clearly see as yet what the end of this transformation may be, though we realize that not only American finance but also American commerce, American industry, and even American social habits have been thrown largely into a state of flux. But it should be obvious that our financial policies and practices, especially in our commercial banking system, must adapt themselves to the changes which are occurring so rapidly throughout American business. We cannot cling forever to obsolete formulas, valuable as these may have been under former and different conditions.

The banking situation in America today, involving not only the control of banking credit, but also the flow of American capital, calls insistently for courage and faith in the manifestly great future of our country. In particular we need a confident and yet critical intelligence, keenly aware of the new economic forces and conditions now exerting themselves in our midst, and prepared to deal with them realistically and progressively. Positive and experienced leadership we must have. Upon the courageous faith and adequate judgment of American finance today will depend to no small extent the vast stake of the American economic society of tomorrow.

SPECULATION IN SECURITIES

Address before the New Hampshire Bankers Association, at Manchester, N. H., May 24, 1929

SPECULATION IN SECURITIES

It is a genuine pleasure for me to have the opportunity to be here tonight, and to discuss with you a few of the many subjects in which the bankers of the country, and the New York Stock Exchange, have a genuine community of interest For my own part, in addition to being what some of my critics delight in terming a "stock market gambler," I happen to be a bank director myself, and naturally have a very real interest in modern banking problems.

In a recent address delivered in Chicago, I ventured to state my views on the subject of stock market loans. As a representative of the leading capital market of this country, I felt it a positive duty to bring together the most significant facts upon this subject, and to make such deductions from these facts as I could. The effort has at least stimulated a more open-minded and realistic discussion of this important topic. If we are ever effectually to solve credit and capital problems of this sort, it seems obvious that we must have a full and frank presentation of the facts relating to them.

Having spoken my mind fully and freely in Chicago on the subject of stock market loans, however, I do not wish to allude especially to that subject tonight. Instead, it seems to me that another task should be undertaken, and that is to investigate the subject of speculation in securities. Too often the words "speculation" or "speculator" are used as merely abusive epithets, only one jump more complimentary than "stock market gambler." Many people seem to have the illusion that they are engaging in genuine processes of thought when they condemn some situation or operation merely because it is "speculative." Unfortunately for such simple short-cuts to the

truth, speculation is a very large and a very serious subject, which cannot be dismissed airily with a mere wave of the hand.

II

The majority of people who have such emphatic ideas concerning the evils of speculation rarely make an effort to define carefully and accurately what speculation really is. At the outset it is necessary to realize that speculation is completely distinct from mere gambling, not only in its legal but also in its economic characteristics. Gambling represents a mere wagering or betting on some fortuitous future event. Speculation, on the other hand, is concerned with the purchase and sale of actual property, and for this reason it is a universal and integral factor in all commerce and trade. Since speculation involves an economic act of buying or selling, it therefore affects conditions of supply and demand. I would like most emphatically to repeat that wagering or gambling is strictly forbidden on the New York Stock Exchange, and if this were not so, the law would sometime in the last century have closed the Stock Exchange completely. In consequence, the phrase "gambling on the Stock Exchange" is merely an abusive epithet which only displays ignorance, unfairness, and often ill-temper.

On the other hand, speculation and investment are in practice most difficult to distinguish. The speculator, of course, is concerned primarily with obtaining a profitable difference between the price at which he buys and the price at which he sells, while the investor is mainly interested in the yield on his investment. In actual fact, however, security investors invariably consider both elements of possible appreciation and possible yield. In the United States, particularly, we have never developed a class interested only in the yield upon their investments. In this great and progressive country of ours, one

must look a long while before he will find an absolutely Simon-pure investor.

Speculation has often been made the scapegoat of our national business situation. It is frankly to be admitted that speculation, like every other good and necessary thing in the world, can be overdone. On the other hand, it is also necessary to recognize that speculation has on the whole played a consistently important and constructive part in the unparalleled economic development of the United States. The very discovery of America resulted from a financial speculation by Queen Isabella of Spain, who pawned her crown jewels at interest rates even higher than those which we have recently witnessed in the call loan market, to finance Christopher Columbus' ideas. The early Massachusetts and Virginia colonies were originally financed by speculation in the shares of two British exploration companies—the Plymouth and the London companies. After our Revolutionary War, when Alexander Hamilton was making his heroic effort to fund the debt of our new Republic by the first large issue of United States bonds, the principal support he obtained for the purchase of these bonds came from security speculators. A generation later when the first American railroads were projected, every one of them at once entailed security speculation. Throughout the nineteenth century, the gradual development not only of our vast railroad system but of our innumerable public utilities, our vast manufacturing establishments, and practically all of our other major productive enterprises in corporate form, had initially to be brought into being and carefully nurtured into health by speculators before they could afford safe investments to security buyers here or abroad. If the United States has risen from obscure poverty to preeminent wealth and high standards of living among the nations, the constant and intrepid speculation in American securi-

ties which has gone on in this country for over a century must be put down as one of the most important constructive factors. Today this process continues. We are, for example, obtaining through the clouds which hide the future, a glimpse of a society in which air transportation will be a commonplace. But to create the future airports, the future manufacturing facilities for airplanes, and the future operating systems whereby commercial aviation can be placed at the disposal of everyone, requires the assistance of the security speculator today. The time will come, doubtless, when aviation securities will be considered among our soundest and most conservative investments, but until that day arrives, the speculator must finance this new industry into being, and must bear the large initial risks which this process entails. So it is, not merely with new industries, but with new operations of old industries. It is a continuing process. Therefore the pious wish which someone has recently uttered that "we ought to put the fear of God into the American security speculator," seems to me rather peculiarly short-sighted. It is perhaps worth while to remark that after all the United States of America was not built by pawn-brokers.

III

Speculation in securities is not at all a bad thing in itself. It is, however, necessary to recognize that we may have too much or too little security speculation.

There have been many times in the history of this country when there was too little speculation in securities. One such instance occurred as recently as 1921. The results of inadequate security speculation are bound to be a lack of negotiability for the leading security issues of the country, a halt in the flow of capital through the security market into

industry, and in consequence a slowing-up or halting of progress in industry and trade. In some European countries today, the insufficient amount of security speculation is in part at least responsible for the difficulty of reequipping industry, reducing production costs, and inaugurating widespread prosperity.

On the other hand, we do not, of course, wish to have excessive speculation. Yet here it is necessary to distinguish between speculation in securities and speculation in most other forms of property. Corporate securities, after all, represent a surplus of wealth devoted to production. Securities are not actually necessities of life, and many people in this country have succeeded in obtaining food, clothes and shelter without buying or owning any securities at all. It is therefore true that the social effect of speculation in securities, or of changes in security prices, is a very different one than that proceeding from speculation or changing prices in basic commodities or real estate. The stock market is in reality a market for surplus capital, and that is the reason why security prices are subject to such constant and sometimes such great changes. In the period of 1919-1921, commercial deflation compelled this country to utilize its surplus, with the result that security prices were seriously deflated, and stock market loans were reduced first and last about 66 per cent. In recent years, however, we have been facing a very different situation—a situation where continually larger amounts of savings and capital were steadily coming into existence. Yet our commodity prices have not been inflated, neither have our commercial inventories been expanded. Our new vast surplus of capital created by this era of prosperity has mainly flowed into the security market. As a result, we have had rising security prices and active security speculation, since the capital market for securities has been acting as a safety valve for our entire economic system. Many

people have not understood this situation, and have been much concerned with various schemes for tying down this safety valve, even at the risk of ultimately blowing out the whole boiler. I have had the feeling myself that we should rejoice in possessing so much surplus capital today, instead of short-sightedly bewailing the situation in the securities markets which it has inevitably produced.

The question remains, however, whether we have really had excessive stock speculation. This is a difficult question to answer, because there are so few reliable or adequate standards by which to measure and judge recent conditions. Undoubtedly during 1928 and the early months of 1929, the volume of shares dealt in upon the New York Stock Exchange was not only actually very great, but was also unusually large in relation to the shares currently listed. So active was security trading that at times it strained the facilities of the Stock Exchange, and for my part, I would prefer to see share dealings on our floor proceed at a somewhat less rapid gait. Nevertheless, I do not know of any definite standards on the basis of which to conclude that even recently share dealings on our Exchange were excessive. It must be remembered that a stock exchange is a very highly organized market where contracts to buy and sell securities can be freely and readily made. As a result, shares may change hands at a high rate of velocity there, irrespective of whether such active trading is accompanied by rising or falling security prices, or by expanding or contracting brokers' loans. The New York Stock Exchange, in a continuous experience of more than a century, has never attempted to set any standards for the proper volume of security dealings on its floor, and, as far as I know, neither has any other stock exchange in the world. I do not believe that even the Federal Reserve authorities who have recently taken occasion to characterize stock speculation as excessive, could or

would attempt to establish any definite standards in this regard. Certainly it is a novel experience, that the volume of turnover in a market for long-term capital should be considered a proper subject for responsibility or intervention by our central banking system.

Any discussion as to the tendencies toward excessive security speculation, as a matter of fact, raises very wide questions not only of an economic but also of a political character. In respect to marketing securities, as well as in respect to marketing almost anything else, there are essentially two different schools of thought, which we might roughly designate as the aristocratic and the democratic. According to the aristocratic view of marketing, the waste of our unregulated economic processes is too large to justify freedom on the part of the individual, and therefore arbitrary control by a select few through open edicts or silent action is necessary. The other attitude, which I have characterized as the democratic school, is equally appalled by the great mistakes which great men frequently have made, and believes Lincoln's assertion that "you cannot fool all the people all the time" to be not merely an oratorical flourish, but a practical fact. As a result, this school of thought, instead of endeavoring artificially to regulate, believes in control by public opinion at large, exerted through mechanisms designed for its rapid and complete expression.

The New York Stock Exchange has always been a hearty adherent to what I have termed the democratic school. It has always believed in the fundamental superiority of a free and open market. It has, of course, many times imposed minor regulations designed for the greater safety and convenience of all concerned, but it has never attempted to determine whether the people of this country should or should not speculate in securities, or to set limits to the extent that they should speculate. Stock brokers

have never endeavored to psycho-analyze individual customers to determine whether or not they should buy or sell securities. This is a matter for the public to decide, and not for the Stock Exchange or anyone else to attempt to decide for it. The Stock Exchange has always depended upon the stock market itself to correct its own collective errors of judgment, by making it continually and fully sensitive and open to public opinion. This course of procedure is naturally open to the same defects as may equally occur in the political elections of any democratic country. The public may sometimes be misled. The attitude of the public mind for the time being may not always be justified. Nevertheless, the New York Stock Exchange has always possessed the deep conviction that public opinion is fully capable of correcting its own temporary mistakes, and that in the long run the verdicts of public opinion are wiser than those of any small group of experts, however profound they may be. Public intelligence, mobilized through the Stock Exchange, has frequently proven correct at times when even the most learned experts have distinctly misjudged conditions.

It must be remembered that while the stock market is distinctly subject to the psychology of public opinion, it is also completely sensitive to economic forces in our society which sometimes even the experts fail to detect or understand. The interplay of economic forces in the stock market will always in the long run offset errors of purely human judgment. Anyone who thinks of the stock market as representing only a state of mind is talking arrant nonsense.

I trust that you will pardon me for getting off into this philosophy of the stock market, but some of these things cannot be too often reiterated. I do not believe that there is any individual or any small group of individuals in the world today intelligent and omniscient enough to tell us just how or when we all should invest or speculate with our own capi-

tal. In these days of experts, I may appear a heretic and a blasphemer for expressing such a skeptical view. Nevertheless, I firmly believe that we must have and can have faith in the ultimate common sense of public opinion, in the economic and business, no less than in the political, world of affairs.

IV

So much has been said concerning the checking or control of speculation in securities today that I propose to discuss a few of the remedies advocated for this purpose.

There are still a certain number of people in this country who think that security speculation should either be completely abolished by legislation, or completely controlled in some way by governmental authorities. In fact, ever since the Middle Ages there have been intermittent attempts to enact legislation for governmental regulation or abolition of financial speculation. Such attempts have always ended in futility, although in the meanwhile they have often seriously perverted the normal economic development of business and finance. The latest important effort of this sort, at least in peace times, was made by Germany in 1896. I will not bore you with the details of this experiment, although they are available and extremely illuminating. It is enough to say that the German anti-speculation laws of 1896, despite the typically German willingness to obey rigid laws and despite all the enforcing bayonets of the Prussian army, caused endless economic harm and ultimately had to be abolished.

Often in the past, excessive speculation has been checked by the extensive amount of financial credit required to carry it on. Under such circumstances, there have developed genuine shortages of credit which have compelled a decrease in speculation and the credits extended to maintain it. Such a situa-

tion developed in this country as recently as 1920. But when there is no actual shortage of credit, this restraining force is naturally absent, nor can it be easily brought to bear in an artificial way. As I recently stated in Chicago, brokers' loans today contain fully as much capital and savings as they do credit manufactured by banking institutions. This point is fundamental in the present situation, and since my Chicago address I have been happy to observe that some of our leading banking authorities were in complete agreement with me in regard to it. In their recent survey upon "Money and Credit and Their Effect on Business," prepared by Dr. W. Randolph Burgess of the Federal Reserve Bank of New York, and Professor O. M. W. Sprague of Harvard University, there occurred the following succinct and accurate analysis of this matter:

> "In the past the bulk of brokers' loans has been furnished by banks and bankers. Under the influence of rates for call loans ruling generally above rates on all other classes of loans, the funds of investors and surplus funds of business enterprises have been attracted into the market in such volume that they now provide very nearly one-half of the total supply. The outcome of this practice remains for the future to disclose."

In my own view of this matter, this vast amount of capital at present invested in stock market loans can only be induced to flow therefrom into security investment by easing credit and refraining from official threats and alarming statements concerning security price levels. This seems to me a logical conclusion to a situation upon whose character I heartily agree with Dr. Burgess and Dr. Sprague. It is enough in this place to point out that as long as we have more capital than we know what to do with in this country, and as long as our potential

supplies of credit remain as great as they are today, there seems little reason for trying to interfere artificially with the course of speculative dealings in securities by attempting to produce an artificial and unreal appearance of credit shortage.

It has also been argued that, in order to diminish speculation in securities, the New York Stock Exchange should abandon its present practice of settling its floor contracts the next day, and establish a term settlement system under which such contracts would be settled only once or twice a month. For many years the term settlement has been urged upon the New York Stock Exchange as a panacea. Its advocates have pointed out that such term settlements were in vogue upon the stock exchanges of London, Paris and Berlin, and that if such a system were likewise introduced upon the New York Stock Exchange, our difficulties and problems with demand stock market loans would disappear. This whole question of Stock Exchange settlement systems is an extremely complicated and technical one. Indeed I venture to assert that scarcely one out of a hundred people who have advocated term settlements on the New York Stock Exchange, really knows just what a term settlement is and what it involves.

The New York Stock Exchange is not simply obstinate and unprogressive in its preference for its present cash settlement system. The Exchange has, as a matter of fact, painstakingly investigated the whole subject of term settlements in the main European markets—such as London, Paris and Berlin —where such systems exist, as well as in Amsterdam which is a cash market like New York and which has refused after careful consideration to inaugurate term settlements there. The New York Stock Exchange today probably possesses the greatest amount of information upon this whole subject to be found anywhere in the world. Even at the risk of boring you with technicalities, I would

like to state a few of the reasons which make the foreign term settlement system undesirable and impossible in New York.

The present cash settlement system of the New York Stock Exchange grew up on the Exchange some seventy-five years ago, due primarily to the desire of American bankers to make stock market loans on demand rather than on time, with maximum safety and liquidity. This in turn compelled the stock broker to settle his bargains each day. These conditions remain today, and the borrowing stock brokers must recognize them. If all American banks should suddenly decide that they preferred to lend funds on securities for a two weeks' period rather than on demand, almost automatically the New York Stock Exchange would have to adapt its settlement system in accordance with this situation. Basically, therefore, a term settlement is not something which the New York Stock Exchange can arbitrarily initiate. For many years the New York Stock Exchange has under its rules freely permitted anyone to buy or sell securities for delivery fifteen days, or thirty days or even sixty days after the date of contract, as well as for delivery the next day. Nevertheless security buyers and sellers as well as money lenders have for generations clearly preferred the present cash settlement system. If there were any basic need for a term settlement system on the New York Stock Exchange, surely it would have exhibited itself in the course of the last seventy-five years.

The second difficulty with term settlements lies in their undoubted tendency to stimulate speculation. Some stock exchanges abroad have in fact wished to introduce and maintain term settlements in order to provide sufficient business for their unlimited memberships, which in some cases are three or four times as numerous as ours. The New York Stock Exchange, on the other hand, because of the steady

growth in its business and because of its limited membership, has never been influenced by any such wish artificially to stimulate the dealings upon it.

Nor is there any sound reason today why such stimulation to speculation need be especially provided. Our century of experience has led us to believe that the cash settlement system is in practice a valuable brake against undue and excessive speculative dealings on the Exchange. For this reason it has somewhat astonished the New York Stock Exchange to find even officials of the Federal Reserve system, who recently have had much to say about the dangers of security speculation, advocate the inauguration on the New York Stock Exchange of a settlement system which would inevitably expand speculative dealings. This paradox only shows the dangers of advocating artificial changes in our security marketing system without thorough knowledge of what such changes would actually imply.

Another difficulty with term settlements lies in the fact that they would in all probability facilitate the iniquitous practice of bucket-shopping. Without getting off into technicalities, I would point out that the system of continuing term settlement contracts from one settlement to another always involves abroad a mutually connected sale and purchase. At the end of a settlement long stock is sold for cash and bought for the next settlement, while short stock is bought for cash and sold for the next settlement. I am not a lawyer, and am not therefore prepared to say whether such a practice introduced on the New York Stock Exchange would be forbidden by the courts. I do remember, however, that the stock exchange which claimed the honor of introducing term settlements in the United States was the late Consolidated Stock Exchange of New York, which some years ago was practically closed by the restricting orders of the Attorney-General of New York

State after a series of bucket-shop scandals. The New York Stock Exchange has fought bucket-shops for about fifty years, and it has a particular hesitancy to advocate or indorse any settlement system which could be so easily perverted by non-Exchange member bucket-shop operators. None of us, I am sure, has any desire to see another recurrence of the bucket-shop scandals of 1921-1922.

A final difficulty with term settlement systems consists in the piling up of contracts in securities for two weeks or a month, instead of settling these contracts each day. When the War broke out in Europe, the dangers of this inevitable tendency in term settlement systems were considered so great that the national governments of England, France and Germany at once prohibited such settlement methods on the stock exchanges of London, Paris and Berlin, and required these exchanges to operate on the more conservative cash settlement basis. In London the end of July 1914, settlement was frozen by the outbreak of the War, and the contracts involved in it were not wholly liquidated until September 1, 1922—over eight years afterward. Today many of the best London Stock Exchange firms refuse to carry over term settlement contracts, and some of them were distinctly opposed to the resumption of the term settlements in London after the War.

In respect to term settlements and other such foreign security market practices, it is essential to remember that the United States is not a European country, and that New York is not a European financial center. In many cases, conditions here are utterly different than those abroad, and our financial machinery and methods must suit themselves to these often unique American conditions. Nothing is more dangerous than to attempt to force upon American finance some foreign financial practice without the most careful consideration and investigation of actual conditions in this country.

The New York Stock Exchange has for many years done a great deal of serious and thorough research work into the practices on European stock exchanges. Where these practices are superior to our own and can be adapted for use in our markets, the New York Stock Exchange has always been not only willing but eager to benefit by European experience. Only a month ago, the New York Stock Exchange inaugurated a new centralized method for delivering securities patterned after the systems employed by the stock exchanges of Paris and Berlin. The New York Stock Exchange is also desirous of seeing introduced into our market, the admirable German methods for handling securities by check and deposit, which have been so successfully carried on for years by the Bank des Berliner Kassen-Vereins and other such German security handling organizations. But the term settlement is not an innovation capable of improving conditions in either the stock market or the money market of New York. When I say that we have in New York a better stock exchange settlement system than those which prevail in most if not any European financial center, I am only reiterating the opinion which many eminent European financiers have frequently expressed themselves.

V

Security speculation is not a moral but an economic phenomenon. In practice, its conduct on the New York Stock Exchange is already carefully supervised by the Exchange, and from economic reasons such speculation is always capable of curing its own excesses. However much one may decry speculative enthusiasm, there is no doubt that it is intimately related to the steady and constructive building up of American business, and the maintenance of high American standards of living. There is no justification whatever for attempting to make security

speculation or security speculators a scapegoat for peculiarities in our present situation with regard to credit and capital.

As many economists have often pointed out, speculation arises primarily from uncertainty, and only represents the inevitable attempt to deal definitely with uncertainty. As long as we have uncertainty, we are bound to have speculation. It might, therefore, be fruitful to consider some of the actual causes for uncertainty which surround the stock market today, in order to more clearly realize why speculation in securities has recently been so active.

One such factor of uncertainty is undoubtedly our unfamiliarity with the present status of the United States as an international creditor nation. For more than a century, America was always a debtor country, where securities were more abundant than capital or credit, and where in consequence they sold at relatively low prices and returned relatively high yields. This situation was in complete contrast during the nineteenth century with the security markets of the creditor nations of Europe. In these European creditor centers, capital and credit were normally more abundant than good securities, with the result that domestic securities generally sold at high prices and returned low yields. Today there are many who feel that America, having become a creditor nation, is evolving the same general type of security price levels which have usually prevailed in creditor countries. Meanwhile the leading European countries have, in varying degrees, recovered from the War, and again become creditor nations. Formerly the overflow of European capital could find a ready outlet in the vast debtor market of New York. Today both Europe and America are beginning to look about the world for other such debtor markets in which to place their surplus capital. Meanwhile, domestic security prices of this and other creditor nations have risen and may rise

still further under the constant pressure of fresh capital seeking investment. Basically many people believe that it has been this situation which really accounts for the long-continued rise in price of the best American and European securities. It is in the main beside the point to compare present conditions in the New York security market with those of 1905 or of 1900 or of 1880, or in fact of any year when fundamentally the United States was still a debtor nation. We are, I imagine, all of us rather confused about how a creditor nation really functions. It will take time for American finance to learn this new and thoroughly important lesson. But meanwhile, this situation does cause widespread security speculation because of the uncertainty as to the permanent levels which, under the influence of constantly increasing supplies of surplus capital, security prices both here and abroad may reach.

A second major cause of security speculation in America today consists in the very rapid changes occurring in American industry and trade. We have never seen a ten-year period in which such momentous and far-reaching changes in our methods of producing, distributing and consuming goods have occurred. One new invention crowds fast upon the heels of another, with sometimes a very immediate and extensive effect upon the earning power and equities behind American securities. In the space of a few years, for example, the graphophone business was almost pulverized by the sudden rise of the radio, and then greatly assisted by uniting with it. Chain stores are spreading over the country at a tremendous rate and, it may be, revolutionizing our methods of merchandising. The automobile traffic, among other things, is bringing about a steady fall in passenger traffic on many of our railroads. The rise of investment trusts has already created a new American financial facility of major importance. There is today intense competition not only within single

industries, but between apparently different industries. Aluminum competes against copper, tobacco against candy. Even the tailor complains that people would rather buy automobiles than new clothes. Hundreds of such shifts in American industry and trade, occurring with constantly greater rapidity, are reflected in the prices and in the present and prospective earnings of American stocks. Inevitably the uncertainty thereby brought about creates speculation in these securities, and as long as these fundamental conditions continue, the turnover in security sales is bound to prove not only actually, but also relatively, great.

An added reason for active security speculation is to be found in our swiftly increasing number of new industries. Throughout the industrial history of this country, the beginnings of an industry have always been attended by active security speculation, because the security speculator must be depended upon to bear the unusually heavy risks inevitably entailed. In order that tomorrow we may have service in airplanes and also airplane investments, there is today active speculation in airplane shares. We are told that we are on the eve of perfecting television, whose commercialization must in turn produce speculation. In the field of new or substitute materials, such as rayon, speculation in securities is created by the very rapidity of scientific progress itself.

Finally, speculation in shares has been rendered greater by the increasing public preference for share as against bond investment. It may prove that this tendency is being overdone. Nevertheless, for many years our most skillful investors have not hesitated to place their funds in the sound business equities of this progressive and growing country. We can scarcely afford to complain if hundreds of thousands of new investors today are endeavoring to do the same thing. Some of us have talked a good

deal in the past about creating a nation of investors. We may have overlooked the fact that these new investors have intelligence and ideas of their own, that they do not need to be lectured to or patronized by anyone, and that, as their experience grows, the skill which they apply to their work of investing is likely steadily to increase. Many of our new investors also speculate, and in the future will doubtless continue to do so. I do not see any reason to raise our hands in horror over this situation. It may be that we all have much to learn in regard to what that hackneyed phrase "a nation of investors" really means anyway.

VI

Before I conclude, I would like to restate as clearly as I can, the position and the policy of the New York Stock Exchange in regard to this question of security speculation and its related subjects.

The New York Stock Exchange holds no brief for the inflation of securities or any other form of property. Since the stock market is essentially a market for surplus capital, the evil effects of inflation are always first visited upon it. In November 1919, for example, security prices began to fall and stock market loans to diminish, months before the inevitable commercial deflation occurred. Stock market loans during 1919-1921 were deflated 66 per cent. without one lender losing a penny, but with most disastrous results to the stock broker and his customers.

The New York Stock Exchange has always been willing to sacrifice mere quantity of operations in the interest of improving their quality. The Exchange's rigorous listing policy has, in the interest of more intelligent security dealings, checked what would otherwise have been vast additions to the securities which can be bought and sold on the

Exchange. Many times in the past in other respects, too, the Stock Exchange's efforts to improve the character of its market have been exerted regardless of the prospective profits to its members as stock brokers or dealers in securities.

The New York Stock Exchange is not itself concerned with the course of security prices, so long as these prices result from a fair, free and open market. The Exchange must always maintain impartiality as between those who wish to see prices rise and those who wish to see them fall. Recently I have been rather embarrassed in being considered a sort of "bull leader," because I have ventured to suggest that the rising values of American security prices during recent years could scarcely be attributed entirely to a public mania. It is not the function of the New York Stock Exchange itself to comment on prices, except to explain how they are actually arrived at, and to point out artificial hindrances to their being established in accordance with unbiased public opinion. It is not for the Stock Exchange itself to attempt to assist the "bulls" against the "bears," or the "bears" against the "bulls," and no such attitude has ever actually been taken by its officers.

The actual interest of the New York Stock Exchange in the recent controversy concerning stock market loans and security speculation is three-fold. In the first place, the Exchange is not only willing but anxious to make entirely public a knowledge and understanding of its regulatory principles, its policies and methods, and its economic functions. At the same time, it is unwilling to sit passively by and allow inaccurate and prejudiced statements concerning these things to pass unchallenged, regardless of from what source such statements may proceed. In a country where free speech is assured, the Exchange feels entirely at liberty to make constructive

suggestions concerning its own and related financial operations.

Secondly, the New York Stock Exchange is unwilling to have foisted upon it responsibility for economic conditions arising elsewhere, or to be impelled to adopt methods of operation which its long experience has persuaded it to be unsound and fallacious. In this respect, the attitude of the New York Stock Exchange is in complete harmony with the best interests of security investors all over this country. The New York Stock Exchange is perfectly aware that changes in Stock Exchange methods are sometimes urged with great persistence for perfectly selfish reasons by interested parties.

Finally, the New York Stock Exchange is willing at all times to cooperate with any one who, motivated by a desire to promote the public interest, is attempting to improve the mechanism of American finance in any of its parts, so that it may increase its ability to subserve the greatest good of the greatest number.

STABILIZING AMERICAN BUSINESS

Address at the Thirty-sixth Annual Convention
of the Virginia Bankers Association,
Old Point Comfort, Virginia,
June 20, 1929

STABILIZING AMERICAN BUSINESS

This is not the first occasion on which I have been the recipient of Virginian hospitality, and I am selfish enough to hope that it may not be the last. The pleasure which I feel in being here with you today is heightened not only by the friends I have made here on former visits, but also by the fact that the financial community in New York includes today so many Southerners. As a matter of fact, Virginia is really a larger part of Wall Street than perhaps it realizes itself.

II

I propose to discuss today certain aspects of the important question of stabilizing American business. Naturally I look at this subject from the angle of my own experience in the Stock Exchange, and as a result my views upon it may be to some extent tempered and prejudiced thereby. Nevertheless, I wish to point out, as impartially as I may, the important part which the New York Stock Exchange has played, particularly in recent years, in stabilizing American business and promoting American prosperity.

The idea of stabilizing business is, of course, not at all new. Yet this practice has recently produced such important results in business prosperity, that some business men have been led to consider it an absolute panacea for almost all kinds of business problems. It is, therefore, worth while to consider just how the idea of stabilizing American business gained its present popularity, and what have been the principal causal factors in so largely achieving it during recent years.

The theory of stabilizing business is, as I have stated, nothing new. Yet during the recent War, it

ceased to be a mere theory and became a vital practical necessity. It was necessary that the War should be won, and the war emergency justified both our government and our business leaders in setting aside economic precedents, and even individual rights. In practically all branches of American business, there arose an era of arbitrary control and administration. Foreign exchange rates were pegged. The money market in New York was rigidly controlled. Not only the production and distribution, but even the consumption of goods, were similarly regulated. While these practices were undoubtedly bad economic tactics, and in many cases verged on practical socialism, there is little doubt that from a military standpoint they were vitally necessary. After the War, however, the arbitrary control of American business was speedily relaxed and abolished. Nevertheless, there has persisted ever since much of the philosophy of controlling business by real or alleged experts.

The severe depression of 1920 soon followed. It imposed hardships upon everyone. It made the business men of this country think about business methods and practices more deeply than ever before. American business asked itself why it was necessary to have these recurrent booms and depressions, and how they might be done away with. This whole subject was widely discussed and evoked an enormous literature. Suddenly we found that we had largely succeeded in stabilizing business, and there followed the recent years when America has been enjoying an unparalleled industrial and commercial prosperity. It is, therefore, of great value to realize clearly how this desirable trend in affairs has been brought about, and what agencies have been depended upon to produce it.

The first causal factor in stabilizing American business has undoubtedly been the new and improved technique of American business itself. The

depression of 1920 led perforce to a new conception of business technique, involving hand-to-mouth buying, low inventories, reduced banking accommodation and rapid sales turnover. The speedy improvement in methods of transportation, both by rail and by motor truck, facilitated this new technique, and other economic conditions were also, in general, favorable to it. As a result, rule-of-thumb business methods were replaced by scientific management. The intelligence of our people was applied keenly and open-mindedly to business problems. There was a widespread movement to gather and compile statistics whereby business conditions could be measured accurately. Legislation played little part in this business revolution. It was a spontaneous cooperative movement initiated by business itself. If we have had greater stability in business than ever before, the credit for this accomplishment must therefore largely be given to the average intelligence and progressiveness of the modern American business executive.

A second important stabilizing factor has resulted from the operations of the Federal Reserve system. Undoubtedly the policy of the Federal Reserve in alternately raising and lowering rediscount rates, and alternately expanding and contracting the total supply of available credit by its open market transactions, has frequently served to smooth out the seasonal and artificial periods of laxity and stringency in the money market. When wisely undertaken and executed, such a policy undoubtedly makes for more stable commodity prices and, in general, more stable business conditions. The Federal Reserve authorities, however, have in my judgment been thoroughly justified in pointing out that the Federal Reserve policy could not be expected to prove any panacea in this regard, and that frequently in the administration of the Federal Reserve system factors other than that of promoting business stability

sometimes had to take precedence. I have only praise for the Federal Reserve system's methods in promoting commodity stabilization, and I think everyone must admit that it has been a very constructive factor in our present-day prosperity.

In my own view of the matter, the most important stabilizing factor of all in American business has arisen from the fact that the United States has recently been transformed into a creditor nation. Capital in this country has been generated faster than it is needed, with the result that American loans abroad could be made without harming our own industrial and commercial growth. Our surplus capital has enabled us to plan vast productive facilities for the future. It has softened the shock of critical situations in particular industries. In our old debtor-nation days, the collapse of certain real estate booms, which we all remember, might well have caused a national panic. It seems to have been the experience of creditor nations always, that the so-called business cycles operated in them with less violence than in debtor nations. It is well known that before the War, England did not have such panics and depressions as we did, and now that we have become a creditor nation ourselves, our surplus capital seems in a similar way to be cushioning the shocks of business difficulties here. On every side in America today, thrift and saving is the order of the day. Our national government has in this movement constructively led the way, by its steady reduction of our national debt. Therefore, as a creditor nation, we can normally expect greater stability in business than we could logically look for as long as we were a debtor nation, and our demands for capital outran our ability to supply it ourselves.

But this status of creditor nation has produced a new danger to the cause of stabilizing business, and that is what might be termed "capital inflation."

Surplus capital must be wisely directed into productive uses, if business stability is to be maintained. In recent years, just this result has actually been accomplished by the expansion in the American securities markets. If our excess capital had been placed in direct commercial uses, we would have had an old-fashioned inflationary period in business upon an aggravated scale. Fortunately, the good sense of American business men has prevented this from occurring. Our surplus funds, for this and other reasons, have found a safe and salutary outlet in the securities market. That is the basic reason for the enormous expansion of new security flotations in this country, and the frequently rising prices for standard American issues. Many people have misunderstood this expansion in the American security market. They have considered it only superficially and by itself, and this is the reason why some have been so ready to term it "inflation" and "over-speculation." Actually the expansion in the American securities market has been an absolute essential to maintaining commercial and industrial stability. Any persecution or artificial restraints upon American security market expansion will at once endanger the very stability which is the motive for such dangerous experiments.

A final factor in maintaining business stability in this country has arisen from the vast investments made during recent years in new productive facilities. The funds which have flowed into the stock market have not simply remained there. They have flowed out again and become available for building new railways, new utility plants and new manufacturing facilities. This steady volume of construction, amply justified by the still unexhausted natural resources of the United States, has proved a valuable back-log to business of almost all kinds. Even when business has been slightly depressed, as it was in 1927, the steady flow of funds through the

securities market into new productive facilities has given stability. In turn, the new productive facilities thus created have led to lower production costs, higher wage scales, increased savings, and the continued stimulation of even greater general prosperity.

III

I need make no apologies for stressing the part played by the New York Stock Exchange in stabilizing American business and creating prosperity. Of course there still are people who proclaim that the Stock Exchange is merely a gambling place without any real economic function. I suppose that such people will always exist, although it is gratifying to note that they become fewer and fewer every year. The stock market today is completely a national institution, and represents the centralization in one market of transactions by millions of security investors all over the United States. The great Irish statesman Edmund Burke once remarked that it was impossible to indict a whole nation. Most of the criticisms of the stock market amount to just such an indictment of the entire American investing class.

Essentially the Stock Exchange is the focal point where the supply and demand for long term capital meet. This supply of capital represents the savings of the American people, plus a proportionately small amount of bank credit, which must be employed in the stock market as in every other business. The demand for capital represents the vast panorama of American securities available for sale in the market. On the one hand, the stock market attracts surplus capital from all over the country and directs it into productive industry. On the other hand, the market offers American investors large and small a vast range of possible investments; he can invest his money through the stock market readily, cheaply

and under safeguards built up by more than a century of experience, in any of the leading enterprises of the land. Such markets for capital have proved essential in all modern countries, and today there are over two hundred stock exchanges in the world. The wealthiest and most progressive countries are invariably those which have the largest and most active stock exchanges, and this must continue to be so as long as the system of private capitalism survives. Paradoxically enough, even Soviet Russia is now attempting to resuscitate its stock exchanges.

The Stock Exchange provides a free and open market which issues instantaneous public quotations and provides a variety of safeguards for public dealings. In this market, supply and demand freely meet, and market prices are determined by the free play of economic forces. The varied and constant price movements show the freedom of the market from artificial control. And yet the stability brought about by the free and open market is a sounder thing than any species of artificial regulation by some little group of experts. It is the stability of health and progress, not the stability of exhaustion and artificial regulation.

No one ever knows, of course, just how much capital in America will become available for investment in securities. Also, no one ever knows just how great the requirements of American industry for capital are going to be, or how great the opportunity for productive investment elsewhere. It is, therefore, impossible to tell in advance with certainty just what the movement in security prices is likely to be. No matter how ably trained any small group of experts might become, they could never arbitrarily and yet accurately forecast these things. It is therefore vastly better to have what we have today—a free and open market which will itself inevitably reveal these basic economic forces. Such

a market can be depended upon to adapt itself speedily, and usually in advance, to the constant shift in economic forces. If additional capital or credit are actually needed for short term commercial purposes, they will be obtained from the long term capital which is invested in securities. Just this occurred in 1919-1921, when the early deflation of securities released hundreds of millions of dollars which were promptly re-lent to American farmers, manufacturers and merchants. Also, falling prices on the Stock Exchange will tend to slow up new security flotations, and thus allow new capital and credit coming into the market to be utilized for short term purposes. On the other hand, excess capital and credit can readily flow into securities and loans upon securities, without causing an inflation in commodity prices and the cost of living. Just this has recently occurred. In the past few years, commodity prices have remained stable largely because security prices and new flotations of securities were steadily rising. Because it is a market for capital, the stock market is in the nature of things a balance wheel for American business, and a profoundly stabilizing force in business.

It is therefore a tremendous mistake to think that the stock market needs continually to be tinkered with. The stock market is in itself a stabilizer, and will speedily adapt itself to any condition where capital and credit are too great or too small for the requirements of business. Recently, what the stock market has done is to tell the truth about the surplus capital and credit in the United States, however inconvenient this truth may have been to those experts who had undertaken to stabilize business conditions according to their own notions rather than according to economic fact.

IV

Perhaps the most fundamental phase of this question of stabilizing American business consists in the

fact that the United States has become a creditor nation. In many addresses which I have made during recent months, I have continually reiterated this point. I consider it absolutely basic to any real comprehension of our present day financial problems.

For over a century United States was the greatest debtor nation the world has ever seen. We never were able to save enough capital to provide for our own uses, and therefore we had continually to borrow financial capital, and also to skimp our own industrial development in many respects. This chronic shortage of capital in America led to recurrent booms and panics. Our rate of industrial progress was constantly limited by the willingness or ability of Europe to finance it. Our capital market was almost always vulnerable because it was a debtor market. Thus the business cycle became a violent alternation of prosperity and depression.

The establishment of the Federal Reserve System was, of course, a tremendous improvement over our old inflexible banking system, and the new flexibility of credit which it inaugurated proved a valuable stabilizing force. But recent stability and prosperity in American business has also been due to the situation in regard to capital. The United States has become a creditor nation with a normal surplus of capital over and above the current productive capital needs of the country. Our real problem therefore is not so much to obtain capital, as to know what to do with the capital which we already possess. It has been this condition of surplus capital in the United States which has inevitably led to the vast expansion of securities listed on the Stock Exchange, to the enormous time deposits in commercial banks, to the increase in brokers' loans, to the vast expansion of building and loan organizations, life insurance company assets and new security flotations. Finally our extensive foreign loans prove the existence of a surplus of American capital over and above the needs of American industry.

Many people have wholly misinterpreted these phenomena resulting from surplus capital in this country. They have observed the rising figures of transactions in finance and have been able to see in them nothing more than inflation. They also fail to realize that the business cycle has apparently ceased to operate in its former accustomed manner. Nevertheless there is the old inherited fear in this country of credit and capital shortages—a fear which used to be amply justified when we were a debtor nation, but which today is obsolete.

V

In considering the function of the stock market as a stabilizer of American business, it is also necessary to consider the ultimate uses of the funds which flow into the stock market. Some people appear to think that such funds flow into the market, and in some mysterious way stay there forever. In reality, such funds pass out into business again, and enable our business enterprises to increase their productive equipment. This occurs indirectly even with issues which have been listed on the Exchange for years. But recently we have had many examples of the direct flow of funds from the investor through the stock market into industry. A recent compilation reveals the fact that during 1928 something over 929 million dollars of preferred and common stock was subscribed for by stockholders of 72 companies whose stocks are listed on the New York Stock Exchange, through the exercise of rights to purchase additional stock in either their or other companies. These figures show not only the function of the stock market in providing capital for industry, but also they reveal the fact that we have not been suffering actually from any shortage of capital in this country. The acquisition of capital in these large amounts by American companies has enabled them, particularly during recent years, to

straighten out and strengthen their capital structure by retiring fixed obligations, to install better and more efficient equipment, to lower their cost of production and to pay higher wages. These processes, as we have all been aware, have been the very basis of recent American industrial prosperity. Under these circumstances, it is both shallow and ridiculous to condemn the stock market as a gambling organization or a mere vehicle for inflation. I would remind such critics that our industrial prosperity today was not planned by experts, but was built up steadily under freedom by the universal thrift and energy of the American people. The flow of capital into our industries upon which our present prosperity depends must not be experimentally operated upon with hack saws by amateur surgeons.

In Virginia perhaps more than in any other of our states, these new forces in our economic life have become apparent. Our southeastern states have astonished the country by their steady industrial progress in recent years. The old state of Virginia has rapidly become a great shipping, trade and industrial center. If you will trace the matter, you will find that very often the capital which has financed this industrial progress here has been accumulated through the operation of the security market. The industrial development of our South has been too long deferred, and I venture to predict that you gentlemen here today are only witnessing the beginnings of it. This development will and should go on. And I know that you will agree with me that our national capital market on the New York Stock Exchange must not be crippled by legislation or by other artificial means, and thereby prevented from continuing the steady flow of capital into your present and future commercial and industrial enterprises. I imagine that many of you gentlemen relish as little as I do the condemning as a "speculative orgy" of the necessary transactions in the stock market whereby this

vast industrial progress here at your very doors has been financed.

May I say that I believe in the essential and fundamental soundness of American prosperity today. I agree with the report recently made by the committee of which President Hoover was chairman, that we have only touched the fringes of possible national prosperity. There are, of course, weak spots in our business structure and more may appear if American business is to be confined within the straight jacket of an artificial credit shortage. But our prophets of gloom and woe are being steadily refuted by the basic health of most of our important industries. I also believe that our prosperity has been due, not to clever legislation or the inspired policy of a few individuals, but to the hard work and intelligent thrift of the entire American people. We none of us need to be superstitious in this regard about economic soothsayers, or any small group of experts entrusted with autocratic control over our business lives. The American people are neither mentally nor morally unfit to manage the prosperity which they themselves have created. I refuse to believe the American people are less able to exercise the prerogatives of economic and financial freedom, than they are to use wisely the political freedom which was won a century and a half ago.

VI

Speaking of stabilizing American business, I think it is only fair to point out that stabilization is not a simple thing, but a very subtle and difficult policy to put into actual operation. Stabilization has been made to seem simpler than it really is by the great vogue of drawing charts. You can chart some line of business activity, and then conceive the brilliant idea of what is known as "flattening out the peaks and filling up the depressions." But the chart rarely tells you just what these peaks and depressions really are.

We cannot, therefore, afford to adopt a policy of hitting any business activity over the head with a club as soon as it begins to seem unusually active, or of jamming credit and capital into any activity whenever it seems dull and depressed. We must always know just what it is that we are depressing by credit restriction or inflating by credit liberality. Many changes in business, particularly during recent years, have not been simply seasonal and artificial, but secular and apparently permanent. Stabilizing the seasonal factor in business is thoroughly sound, but interfering with the secular progress of business is distinctly harmful.

We have probably all been intrigued by the idea of a few experts sitting in a room somewhere with charts and regulating from them the trends of business. Such an idea can readily be made into an exciting "movie" scenario or a thrilling advertisement. In actual life, however, stabilizing business is not so delightfully safe or simple. If the natural future trends of business are correctly anticipated a genuine public service will be rendered and temporary economic misalignments will be minimized. But if the analysis is not correct, the attempt to stabilize business by such tactics constitutes simply a public nuisance.

In this connection, there is another matter to which I should briefly refer. Recently it has been urged that a five per cent tax should be imposed in this country upon the sale of all stocks which have not been held for more than sixty days. That such a tax would be prohibitive is apparent when it is realized that the present tax on stock sales, which is already at its highest rate in American history amounts to about 1/50 of 1%. The proposed rate would therefore be 250 times as great as the present rate. The existing tax produced in the calendar year of 1928 slightly over $30,000,000. If the proposed tax did not reduce the activity of the security business of the country it would yield over

$7,500,000,000—of course a wholly preposterous situation.

The proposed tax does not therefore represent any legitimate attempt to raise revenue at all but rather an attempt by the artificial use of the tax power to regulate the American security business. There is no doubt whatever but that so huge a tax would prove profoundly harmful not merely to all American stock exchanges, but to American finance, commerce and industry as well. For more than a century the New York Stock Exchange and the other stock exchanges of the United States have provided American business with free and open market places for securities. The ready buying and selling of these securities has made it possible for our banks to lend with confidence on security collateral. It has also permitted American business corporations readily to issue and distribute their securities to the American public. This normal and necessary work, so basic to stable prosperity in the United States, would become impossible of accomplishment were the proposed tax to be enacted.

Undoubtedly such a tax would force people who desired to deal in securities to evade it in one way or another. This might be done through secret transactions where no records were kept by which the government could discover what taxes were payable, or by selling American securities on the stock exchanges of Europe instead of in our own country. Yet despite such evasion such a tax would constitute a most dangerous blow to stable business prosperity in the United States. From the banking standpoint, more than $6,000,000,000 have been loaned by banks and other lenders of money on collateral securities, and the vast majority of these loans are call loans on securities listed and dealt in upon the New York Stock Exchange. In the past these loans have always been safe because, if the borrower did not promptly pay a loan when it was

called, the lender always had an active market in which he could sell out the collateral for more than the amount of the loan. But if the active market on the New York Stock Exchange were to be shattered by excessive taxation, call loans would of course become illiquid, the forced sale of their collateral might on occasion produce less than the amount loaned, and the losses thus entailed might result in serious banking insolvencies throughout this country.

The proposed tax would also interfere with corporate financing in this country, and particularly in our new industrial states where the field for new industrial development is particularly great. Without a free and open market for securities on the Stock Exchange, American bankers would be unable to underwrite American securities. This would throw our underwriting business abroad into the lap of foreign bankers, who would be able to use the active and free stock exchange markets in their own countries without any danger of any such prohibitive taxation. The net result of the tax would therefore be to sacrifice present-day American financial leadership. So grave would be the consequences of any such development as this, that I cannot believe any such tax bill will ever be seriously considered on its merits in this country. Yet the mere fact that such a tax has been publicly urged, indicates how little real thought is sometimes given to those economic and financial processes which are indispensable if stable business prosperity in this country is to be maintained in the future.

VII

Today economic and financial progress are engaging public attention as never before in our history. As someone has put it, political economy has achieved the headlines in our newspapers. A vast process of educating the public in the facts of modern economic

society is steadily going on. To me this is all a very hopeful sign. It means the increased likelihood of accurate and intelligent solutions for our national economic and financial problems. At such times, of course, some will always try to capitalize public misunderstandings in regard to American finance for their own private and selfish ends. However, as the old saying is, "the truth is mighty and will prevail." The day is rapidly passing when serious bankers or business men in this country will allow our national problems to be settled on the basis of prejudice or abusive epithets, or mere rant and nonsense. The whole American people are today beginning to participate in financial transactions of all kinds. More and more every year the witch doctors of finance are proving a vanishing tribe, and the time will come when they will be as extinct as the dinosaur. In these days, the American public seeks facts rather than mere opinions, and it cannot be hoodwinked concerning facts as easily as some appear to think.

Today we are in the peculiar position of being financially a creditor nation, but still with the mental and psychological attitude of a debtor country. The force of circumstances can, however, be depended upon to give us understanding. We do not need panaceas or artificial legislation. Mere pride of supposedly expert opinion must yield place before the hard facts of the new society which we are building. The universal American thrift and intelligence which have created the progress and prosperity of American business will continue to manage and administer it.

NEW ASPECTS OF AMERICAN CORPORATE FINANCE

Address at the Thirty-third Annual Convention of The Indiana Bankers Association, at Evansville, Indiana, September 11, 1929

NEW ASPECTS OF AMERICAN CORPORATE FINANCE

So many contacts exist between the securities market in New York and American commercial banks throughout the country, that I always feel it a genuine privilege to attend conventions of interior bankers. I must confess that my mission here is as much concerned with learning about banking conditions as it is with endeavoring to explain the functions and operations of the Stock Exchange.

Everyone recognizes that the vast expansion of our American security investing class has brought about a more widespread interest in the security market today than ever before in our history. The New York Stock Exchange was from the beginning designed to provide a market where the American public could freely buy and sell our leading securities, and this expansion of American security investors is therefore only causing the Exchange to fulfill a traditional function. Very naturally the Stock Exchange, like everyone else, has every reason to wish to see a continuance of American business prosperity, and the widespread distribution among the people of the securities of American business corporations.

The great public interest in finance and in the security market at the present time is in one respect rather unique. Formerly, public interest in American finance was widespread just after some calamity had occurred. So it was after the panic of 1907 and the period of serious deflation in 1920. Today, however, we are not worrying about how we should recover prosperity, but rather how we may preserve it. There is a general disposition to hunt out possible sources of weakness in our financial situation and eliminate them before they can effect serious injury to business conditions. In my own view,

this unusual solicitude for financial soundness is a very good thing, provided that it does not lead us into hasty and ill-considered action which would interfere with our business machinery. Our present period of industrial and commercial prosperity was in reality not so much created by legislation or economic theories as by the course of largely unpredictable events and the capacity of American business men.

We should also promote the realization that American finance is not a separate compartment of business, walled off completely from commerce and industry, but rather an integral and living part of an organic whole. In discussing questions relating to American finance, we must constantly re-examine the relation of our financial system to business as a whole, rather than attempt to deal with it as a subject entirely apart.

II

When one says "American business," reference is necessarily made to all manner and kind of business organization, large and small. More and more as time goes on, however, broad discussions of American business relate closely to the American stock corporation, since to a constantly increasing extent it is the corporation which is being employed to conduct business operations. In the United States as in other countries, business enterprises frequently start in a very small way—sometimes with the operations of an individual or a small partnership. Such initial business organizations must depend for their financial growth upon small accumulations of private capital privately obtained, upon loans which they contract at the banks, and upon their own savings. As a rule, however, an expanding scale of business operations tends to lead the individual or the small partnership into incorporating the given business

enterprise. Undoubtedly, as a general thing, the corporate form possesses great comparative advantages in its superior convenience of operation, its perpetual charter, its limited liabilities, in some respects its greater relief from burdensome taxation, and its increased ability to obtain additional capital for expansion. All these forces have operated with particular energy during recent years, and have resulted in the rapid creation of many new business corporations in this country.

The adoption of corporate form at once introduces the American business enterprise to the long-term capital market for bonds and shares. By the same token, it of course opens to business enterprises the many facilities furnished by our banks for financing, not only through regular commercial loans, but also through new security issues, through loans made upon security collateral, and sometimes through direct bank investment in security issues themselves.

There then remains a further stage in corporate financing which is reached when the corporation becomes of considerable size, and desires to make its securities readily negotiable to investors scattered over large areas. It is at this point that stock exchanges enter into the important work of assisting in the financing of our business enterprises. Corporations, for example, come to the New York Stock Exchange to list their securities, in order that these securities may be readily and regularly purchased and sold by anyone in the country, and also to obtain through this entry into the New York stock market a gradual and inexpensive distribution of their securities among our vast class of American investors. When a stock issue is listed on the Stock Exchange, bankers are more willing to lend money upon it, since during the life of their loan they can obtain instant and reliable price quotations for the issue, and since in case the price of the issue declines seriously in the market, they can

depend upon selling the collateral if need be to protect themselves from loss.

When a bank in this way lends money on securities, it may be assisting the private operations of some speculator in securities. But this is only a superficial aspect of the story. Such brokers' security collateral loans constantly enable American business corporations to distribute larger security issues than otherwise could be distributed, and this results in a vastly increased facility for financing our business corporations. The modern American business company cannot in practice wait to sell its shares completely to outright and permanent investors. For growth and expansion, our business companies need funds in large amounts at one time, not in small driblets of capital slowly and painfully acquired. The machinery of the stock market, and the call loan market on securities, enable just this thing. Statistics show that the highly successful U. S. Steel Corporation has not even yet managed to sell all its common stock to outright, permanent and unequivocal investors. Yet despite this fact, the Steel Corporation was enabled over 25 years ago to obtain its initial capital at once and to commence operations, by virtue of the fact that the amount of Steel stock, which investors did not care to buy, could be sold to speculators and held in security collateral envelopes until investment demand developed sufficiently to withdraw it into private strong boxes all over the country. It is not too much to state, therefore, that one reason for the swift and energetic development of business enterprise in this country, as compared with many countries abroad, lies in our superior facilities for making security collateral loans and holding new securities in the market floating supply until investment demand develops for them. It is after all because we have in our financial system provided superior facilities for financing American business corporate growth, that

our business enterprises have been able continually to expand and progress.

III

The financing of our American business corporations has been profoundly affected in recent years by the fact that the United States has become a creditor nation. American investors have always quite naturally preferred to place their savings in securities of their own country rather than in the issues of other countries. There is no reason to consider our investors peculiar in this respect, for exactly the same tendency has occurred in practically every other country where security investing has attained any size. But before the War, when the United States was still a debtor country, this practice of investing in domestic securities was almost forced upon us because we regularly suffered from a chronic shortage of capital, and regularly needed to employ for our business financing not only all of our own national savings, but also a considerable portion of the savings of other nations.

After 1921, however, the United States began to accumulate investable capital so rapidly and in such large amounts that we became able for practically the first time in our history not only to finance our own business undertakings, but also to lend large sums of money each year abroad. At first the shortage of capital in Europe which followed the War was so pronounced that foreign loans on an emergency basis from the United States were frequently entered into, and offerings of foreign securities in our markets swiftly became a very considerable factor in our new financing. There is little to criticize, I feel, in this development. It would have been impossible to have maintained our large export trade if this financial assistance had not been freely tendered to foreign buyers of our produce and

our merchandise. From the standpoint of American investors also, the development has caused, thus far at least, little real difficulty. Few if any foreign dollar bonds listed on the New York Stock Exchange since 1921 have defaulted upon their coupons, and as a group they have experienced a considerable rise in price. Nevertheless this extensive investing in foreign securities ran contrary not merely to the experience of our investors, but also to the conception which Americans generally had as to the comparative value of American and foreign security issues as investments. I would like again to insist that our preference for American security issues is not entirely a matter of blind national pride with us, for some of the ablest bankers and capitalists of Europe have recently shown that they too consider our securities as a general thing more attractive as investments than their own issues.

It is also true that the New York securities market has recently proved much more intelligently selective in its price movements than is commonly realized. Many security issues have of course experienced great price advances, but, on the other hand, many American security issues have not only failed to advance in price, but have declined in price. All this indicates, to me at least, that American investors are going about their business with an intelligence and discrimination remarkable under the circumstances. It may be, of course, that this marked discrimination shown by our investors in selecting certain issues and disregarding others can be attributed to the great growth of investment trusts and the significant increase of experienced financial investment services.

With most European countries which have become creditor nations, there has been a pronounced and indeed cumulative tendency to invest abroad because of the insufficiency of domestic opportunities for investment and the difficulty of increasing these. It

is obvious that this is not likely to be the experience of the United States. It is true that we have reached a stage of economic development where we possess a surplus of capital over the ordinary needs for our business development. Nevertheless, the exploitation of our natural resources and our inventive ability have as yet shown few if any signs of reaching an end. A country as rich in natural resources as the United States, and as ingenious in perfecting new inventions, can greatly expand its legitimate demand for long-term capital. Indeed just this development is occurring today under our eyes.

Coupled with this great expansion of American business development which our abundant capital has permitted, is the marked preference on the part of American investors for shares rather than bonds. The present unpopularity of bond investments may in some measure be attributed to the erratic movements in the interest rates for short-term money which have had the effect of alternately advancing and decreasing bond prices. One of the inevitable costs of attempting arbitrarily to regulate interest rates for short-term loans is bound to be an increasing skepticism on the part of investors as to the profitable character of bond investments. But an even more important factor, in my judgment, has been the very attractive character of share investment under our recent national economic conditions. Since the United States possesses a surplus of capital, it need no longer be as wary of share investment as in former times when share prices were rendered over-sensitive by our relative shortage of capital. Not so many years ago, share investment was in fact looked upon as distinctly a risky pursuit, and in the popular manuals explaining security investments, shares were often entirely omitted from consideration.

Today the great investing public of this country has abandoned this view of the matter, and the

course of security prices has thus far very largely justified its preference for share investments. Our present tendency to invest in shares may, of course, be overdone, particularly as share prices rise and bond prices remain relatively stationary. But undoubtedly, as long as our investing public is so strongly persuaded of the superior attraction of shares as investments, this strongly marked preference is bound to prove an important factor not only in financing our corporations, but also in conducting the affairs of our stock exchanges, and even our commercial banks.

Under the influence of this vast public demand for share investments, American corporations have very considerably changed their methods of long-term financing. Formerly, when American capital was relatively scarce, American corporations tended to finance their fixed assets with bond issues, and to obtain their working capital from banks by means of commercial loans and advances. Companies with this species of capital structure were so heavily burdened with debt as to be continually vulnerable to business depressions and money market troubles. Today our business corporations are more and more avoiding the issuance of bonds, and are resorting to the issue of shares in order to avoid short-term financing at their banks or with open market commercial paper

This new trend in corporate financing has resulted in important changes in the business of finance. In the Stock Exchange our bond market has experienced diminishing activity at the very time that dealings in shares have obtained the greatest volume in our history. Similar changes have occurred in many commercial banks, where loans on security collateral have increased at a time when holdings of open market commercial paper have greatly diminished and even credit advances of business corporations have frequently remained stationary or have actually

declined. It is of course natural that the conservative banker or broker should be inclined to question so radical a change in our system of corporate financing. Yet it remains undecided whether it should be lamented or approved. Undoubtedly the larger American corporations are today in better financial shape than ever before in our history, and this superior financial condition not only inures to the profit of their shareholders, but also should enable the companies themselves to withstand better whatever difficulties the future may hold in store.

As financial men, we must always remember that finance is after all not merely a business in itself. From an economic standpoint, the fundamental value of finance lies in the facilities which it lends to the production and distribution of goods. If business itself is prosperous, we must not complain too much of the adjustments which this prosperity is producing in banking or stock brokerage. It is rather for us to adapt our own methods so that finance may continue and even increase its ability to facilitate industrial and agricultural production and mercantile distribution.

IV

In speaking of the new financial technique which our current era of prosperity is calling for with increased insistence, it becomes necessary for us to take stock of the nature of the services which finance renders manufacturing and commerce. For, while the present emphasis on share financing has undoubtedly minimized or obviated old financial problems, at the same time it has created new problems with which we must deal rationally and intelligently. One such problem is, of course, with that new and rapidly multiplying financial agency—the investment trust. The Stock Exchange has recently been giving careful attention to this subject, as is evidenced by

the new listing requirements which the Exchange has recently adopted for the admittance of investment trust securities to the Stock Exchange market. But while I think that the Stock Exchange has made a very good start in dealing with this complex problem of investment trusts, I also believe that bankers and stock brokers alike must continue to give this question careful and continued thought and study.

Already investment trusts have become a considerable factor in the absorption of securities in this country, and the direction given to the new investment of American capital. Because of the extreme complexity of their nature and their operations, the Stock Exchange is rather skeptical about the possibility of drawing up any private regulations or public laws as to the specific methods which American investment trusts should and should not use in their business. On the other hand, the Stock Exchange has been impressed with the desirability, from the standpoint of the American investor, of frank publicity as to the operations of investment trusts which seek and obtain capital from public investors at large. Such publicity is not, of course, in itself any panacea against possible misfortunes which may occur to investment trusts. But in lieu of a better method of approach, it has seemed desirable to request these investment trusts which list their securities on the New York Stock Exchange, to provide our investing public with reasonably current and complete statements as to the scope and nature of their operations.

Another problem to which the new technique of financing American corporations has given rise, is of course that provided by brokers' loans. I have no intention of plunging into that thorny and complex subject today, except to point out the vital relationship which exists between brokers' loans and the expansion of American business corporations. We have all noticed that in these recent years when

brokers' loans were expanding, there has been a parallel expansion in the new security offerings to American investors in the form of share issues. There has also been an enormous increase in the number of shares listed on the New York Stock Exchange. At the beginning of 1925, there were listed on the Exchange 433 million shares all told. Today, more than one billion shares are listed there. Thus, in five years the expansion in our share listings has more than doubled the amount of shares which had accumulated on our list in the course of over a century. These figures by themselves indicate how widespread the tendency toward corporate share financing in this country has become during recent years.

Very naturally, not all these newly created shares in American enterprises have been able to find immediate outright buyers. The result has been a considerable increase in the floating supply of securities in the New York market which is being carried by brokers' loans. One may, of course, argue that brokers' loans are too large, but one cannot truthfully declare that brokers' loans are in themselves a non-productive or harmful form of financial investment. For the floating market supply of securities sustained by brokers' loans makes it possible to render immediately negotiable many billions of dollars of security issues outstanding in this country and listed on the Stock Exchange, as well as to enable reliable quotations regularly to be made for these issues, and gradually but inexpensively to further their distribution to outright investors all over the land.

I imagine that interior commercial banks must constantly ask themselves whether their loans on call are depriving their localities of funds needed for the prosecution of local business. Undoubtedly, as long as we have an independent banking system in this country, rather than a branch banking system

like that of England or continental countries, it must remain the first function of a bank to take care of the financial needs of its immediate locality. Moreover, it is in the great majority of cases to the distinct self-interest of an interior bank to make local loans rather than to lend its funds in New York on call. Nevertheless, interior banks have long since discovered that there is such a thing as overlending in their immediate localities, which is attended, if carried to extremes, by the danger of suspension or insolvency. After all, it has been this fact which was responsible for the creation of the call loan market in New York many years ago, when it was necessary to provide a mechanism whereby our independent banks could lend their surplus funds safely and yet in such liquid form that they could be readily withdrawn on demand. The call loan market in consequence has proved year after year a very useful facility to bankers throughout this country, and in addition has permitted the ready financing of American business in corporate form. I do not believe myself that this system has actually imposed any particular hardships on local borrowers.

The employment of the call loan market in New York is an inevitable result of our independent banking system, and far from being any detriment to that system, I believe that it has been always a great convenience and facility to it, and occasionally an indispensable factor in it. After all, it has been with this system that our vast present-day business prosperity has been built up. I think that arbitrary interference with brokers' loans is therefore more likely to injure prosperity than to maintain or increase it. None of us of course wishes to see credit inflation. Certainly we of the New York Stock Exchange are particularly unwilling to advocate any methods or policies which seem likely to result in credit inflation, if only for the reason that credit deflation is always visited first on members of

the Stock Exchange and their customers, and as a rule more severely than upon other classes in the community. But while we none of us want inflation neither should we wish on purely theoretical or dogmatic grounds to kill a goose that has been laying golden eggs.

V

Already many people have wondered if the great public preference for share investments today has not led us into a condition of "inflation." We must not, of course, consider every price advance or any other increase as necessarily inflationary, nor should we use the term "deflation" on every occasion when prices fall or the volume of business declines. This much about the present investment situation seems obvious—that in this country we are experiencing a supply of capital in excess of our safest and most obviously profitable securities. When analyzed, I believe that it is really this excess of capital rather than any actual straining of our credit situation which has accompanied the considerable rise in many security prices recently. A little observation of Stock Exchange share prices over the last few months will soon lead to the realization that many securities have during this period declined rather than advanced in price. If our security markets are suffering from inflation, then it is an inflation proceeding rather from the rapidity with which we are generating new capital, than from any particular recklessness with which we are employing credit.

I suppose that theoretically a nation might possess too much capital, although such a condition is, of course, hard to conceive. Some economists, however, have already taken the position that we are saving too much, and that it would be better if we consumed a larger part of our national savings. This seems, however, a mere counsel of extrava-

gance, particularly in a new country like our own which calls for the steady investment of such vast sums of money each year for new productive equipment. It might help if our national debt were retired somewhat less rapidly than it has been, thus avoiding the annual displacement of many Federal government securities and the creation of a proportionate demand for other security investments. In my own view, however, it is a somewhat perilous business to attempt to discourage savings, as such an endeavor might readily prove a serious handicap to our whole program of prosperity.

The question then arises whether more good securities can be made available to absorb our excess supplies of capital. Indeed, this is already being done through the reorganization and expansion of American business corporations, and the purchase of foreign securities. But here again, new and critical problems arise. The extensive regrouping and merging of American business organizations which has for some time been proceeding so vigorously represents fundamentally a better and more efficient organization of business. But there may be cases now and in the future where it represents only a desire to extend control over business properties by means of the ready facilities which the markets today offer for new share financing, without bringing to the situation those improved methods which make these combinations desirable. I do not wish so much to attempt to answer this tremendously complicated question, as simply to indicate the nature of the financial problems with which in coming years we are most likely to be forced to deal.

The innumerable problems arising from foreign investment are already, I think, fairly familiar to American public opinion. I do not wish to be understood as in any way decrying or deprecating the sound economic value of possessing good foreign investments. Nevertheless, we must realize that here

also our surplus of capital is giving rise to national problems of a new and sometimes very complex character. There would be, of course, no economic justification for employing large amounts of American savings to finance foreign governmental extravagances or foreign non-productive business enterprises. No sensible American, either, wishes to see this country launch forth into a career of imperialistic aggrandizement abroad based on the foreign lending of American funds.

I have mentioned these many future financial problems in order to indicate what seems to me one of the most important functions of the stock market on the New York Stock Exchange at the present time. The ability of this free and open market to reflect the interplay of forces involved by the investment of American capital each year is well known. As long as this free and open quality of the Stock Exchange markets is not impaired by injudicious restraints, it may serve us all in clearly indicating the real nature of our financial and economic problems with investment, as well as in facilitating the process of adapting our financial practices and institutions to the basic needs of production and distribution. The stock market is a producer of economic equilibrium, not a menace to it. In the rapidly expanding financial and business empire of the United States, it can be depended upon sensitively to indicate not only the problems which confront our future, but also the forces which in the present have brought us prosperity beyond the experience of any people at any previous period of history.

THE PRINCIPAL CAUSES OF THE STOCK MARKET CRISIS *of* NINETEEN TWENTY NINE

Address before The Transportation Club,
of The Pennsylvania Railroad,
Philadelphia, Pennsylvania,
January 25, 1930

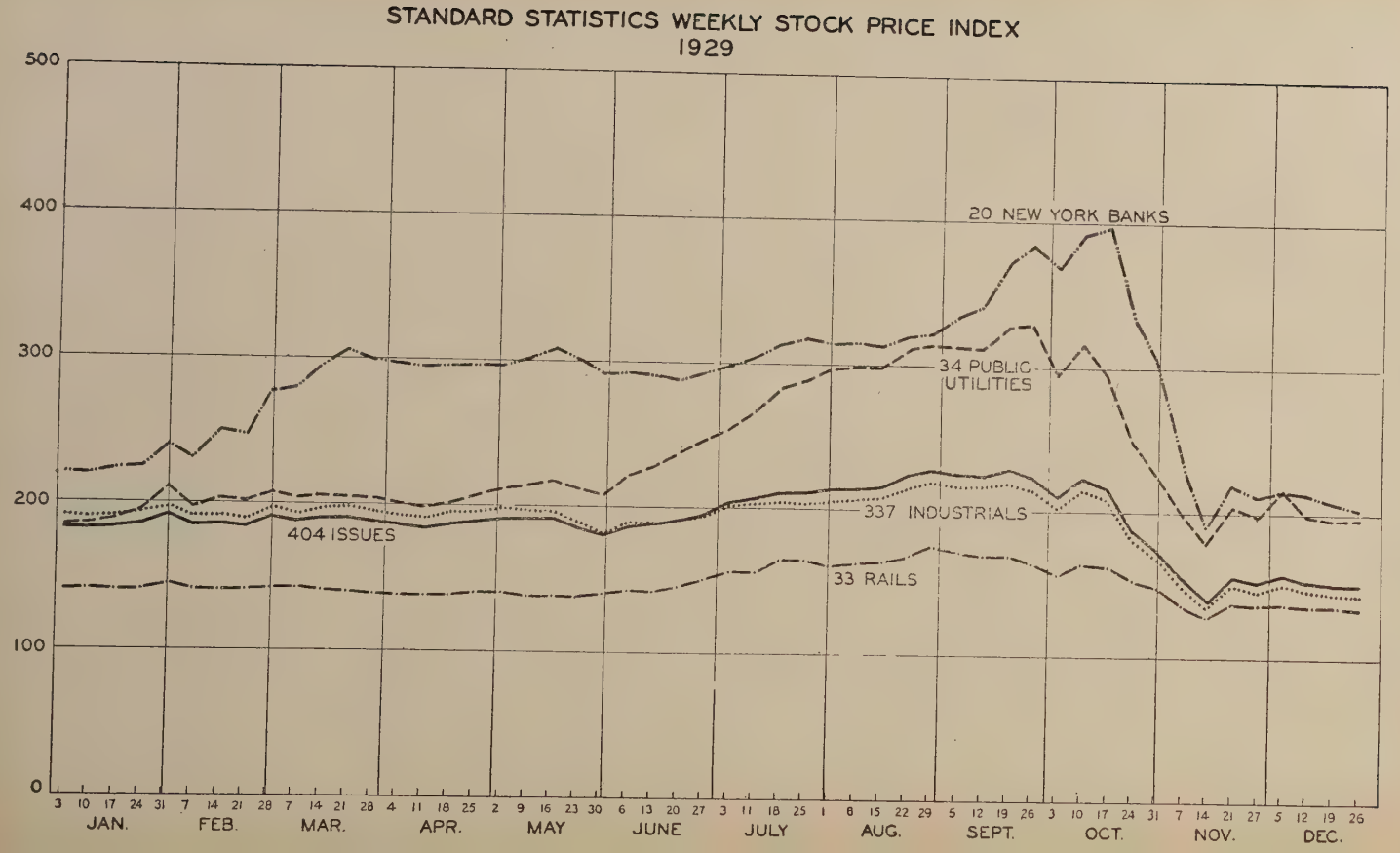
THE PRINCIPAL CAUSES OF THE STOCK MARKET CRISIS OF NINETEEN TWENTY-NINE

In addressing you tonight, I feel that I am maintaining the long established relationship between American railroading and the securities market on the New York Stock Exchange. Just a century ago this year the first American railway stock—that of the Mohawk and Hudson Railroad—was listed on the Stock Exchange. Ever since, the continued activity of the leading American securities market has induced a flow of capital into American railroad systems that has been indispensable for them in their continued work of colonizing a continent.

It would, no doubt, be useless for me to attempt to address you tonight on any other topic than the stock market crisis of last autumn. The causes of this crisis were both many and controversial, and I have no intention of inflicting a lengthy economic dissertation upon you. I only desire to comment upon the most important causes of the recent financial disturbance. I am not going to attempt to discuss the actual events of the crisis or the way it was met. Naturally no one, and least of all the New York Stock Exchange, has any desire to see such financial panics recur and it is essential at the present time to analyze their causes in order, if possible, to obviate them in the future.

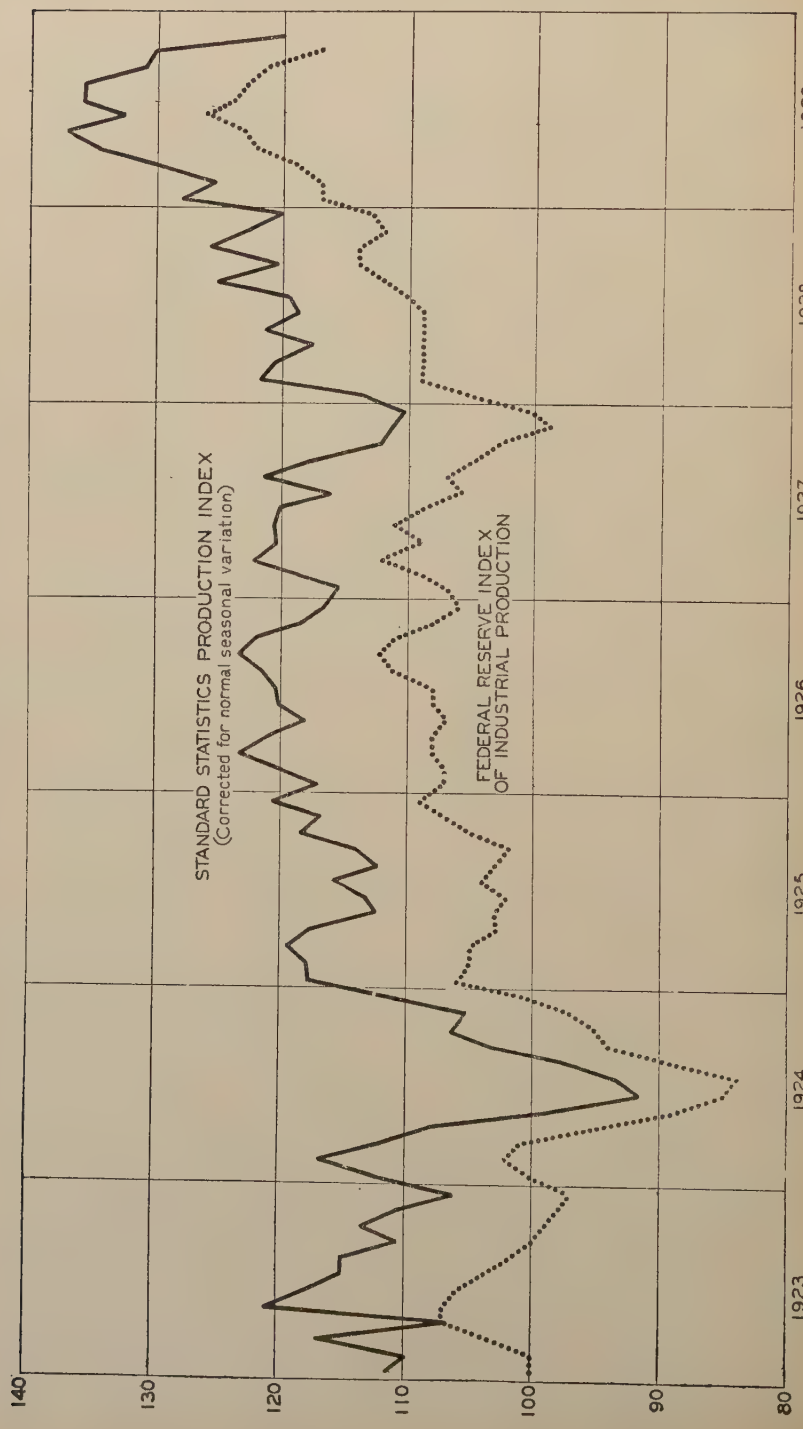
II

The primary cause of the panic was undoubtedly the high level of prices which so many leading American share issues had attained. As a result, various forces making for declining security values


STANDARD STATISTICS WEEKLY STOCK PRICE INDEX
1929
500
400
300
200
100
0
20 NEW YORK BANKS
34 PUBLIC UTILITIES
337 INDUSTRIALS
404 ISSUES
33 RAILS
3 10 17 24 31 7 14 21 28 7 14 21 28 4 11 18 25 2 9 16 23 30 6 13 20 27 3 11 18 25 1 8 15 22 29 5 12 19 26 3 10 17 24 31 7 14 21 27 5 12 19 26
JAN. FEB. MAR. APR. MAY JUNE JULY AUG. SEPT. OCT. NOV. DEC.

encountered in the early fall a stock market whose high prices rendered it very vulnerable. This situation is clearer now than it was only a few months ago. In all fairness, however, it must be said that the price levels of the share market are almost always peculiarly difficult to judge because of the inadequacy of existing methods for measuring them. Almost everyone interested in the subject is bound to use stock indexes or stock averages, and to depend upon them. Yet a close examination of such price averages shows how unrepresentative they often are, and in what an offhand manner they are frequently composed. I feel that our statisticians can do us all a great service if they will concentrate their attention on the production and critical interpretation of better stock price indexes.

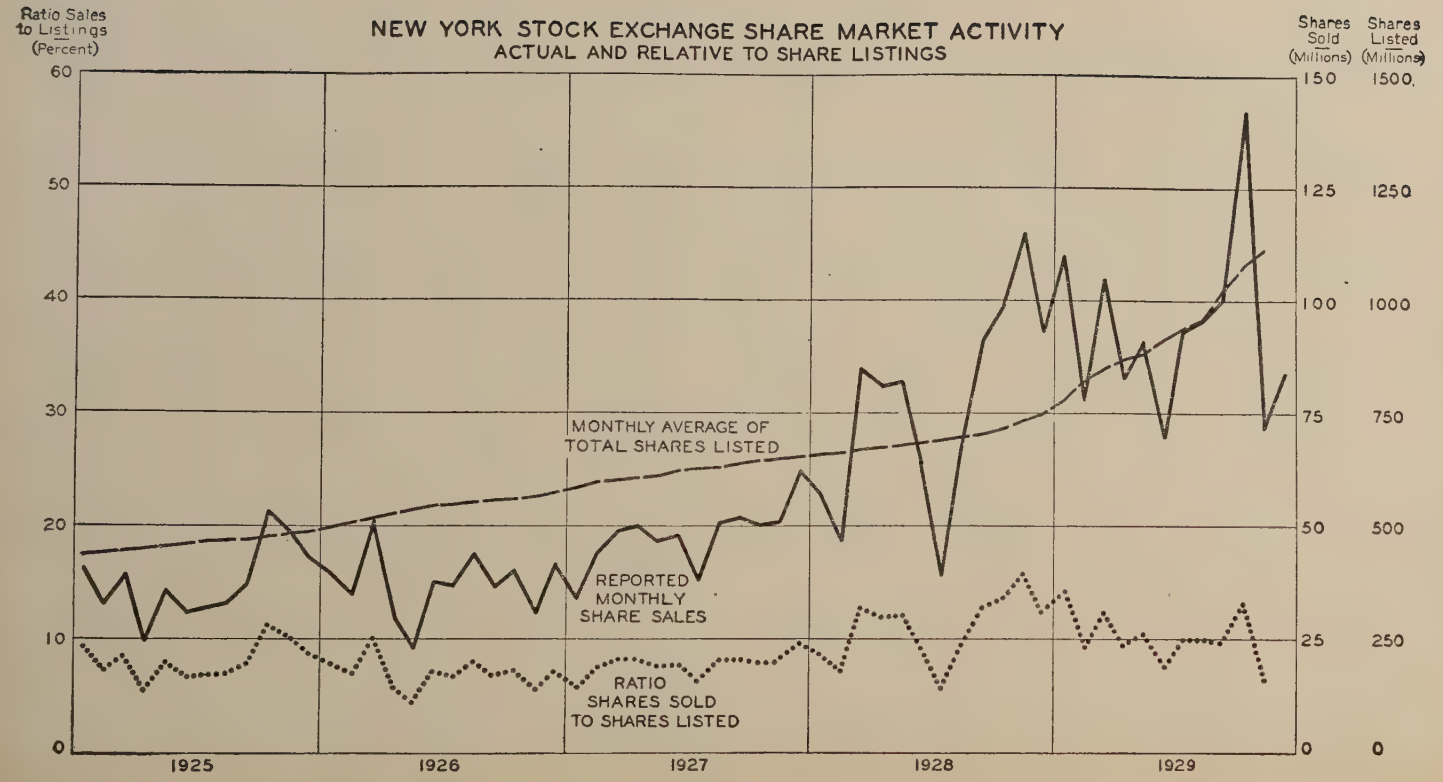
In this connection I would like to draw your attention to certain practices the true effect of which have been misunderstood by the vast majority of investors and which contributed in no small degree to the high level of security prices existing last summer. The payment of periodic stock dividends instead of cash dividends is a recent development of American finance. While this practice is essentially sound if the corporation paying the dividend makes a proper charge to its earnings for the stock issued as a dividend, it has, nevertheless, mislead many persons who have considered the market value of the stock received as the equivalent of a cash dividend. In a rising market each successive dividend seems to be larger than the last and a security paying such dividends is therefore deemed to be more valuable even if the fundamental factors which ultimately determine real value remain unchanged. Conversely, in a declining market, each dividend is worth less and the market value of the security is reduced proportionately. The violent fluctuations of the securities that were paying periodic stock dividends instead of cash dividends is eloquent


INDICES OF INDUSTRIAL PRODUCTION
STANDARD STATISTICS PRODUCTION INDEX
(Corrected for normal seasonal variation)
FEDERAL RESERVE INDEX
OF INDUSTRIAL PRODUCTION
140
130
120
110
100
90
80
1923
1924
1925
1926
1927
1928
1929

proof that the public misunderstood the true effect of this practice.

Another contributing cause was the practice of gauging the value of securities by multiplying their most recently reported net earnings per share by some factor which was deemed to be applicable to the industry in which the company was engaged. This method of valuation, while perfectly proper, leads to inflation in periods of great industrial activity. It is also apt to be misleading if the earnings statements of our leading companies are not sufficiently detailed so as to allow security owners to determine whether the company is reporting all of its net earnings or is concealing part of them by charging off unusual amounts for depreciation or otherwise secretly ploughing back large sums into their properties.

It is obvious, however, that the high level of share prices last August rendered the stock market vulnerable to a considerable price decline. This decline commenced in an orderly manner as soon as it became evident that there had been industrial over-production, particularly in automobiles and steel. This over-production, which is clearly shown by the indices compiled by both the Federal Reserve Board and the Standard Statistics inevitably lead to the slowing up of industrial operations and a decline in corporate earnings. The high level of prices was in large part due to the amazing and steady rise in production of American industry. When it became evident that this process had reached its peak and had started to decline, doubt and hesitation as to the real value of securities was the natural consequence. It seems strange now that the public failed last spring and summer to be more skeptical about the ability of American industry to maintain its tremendous current rate of production throughout the winter. But no one can ever actually tell just when production is being overdone, especially in an


NEW YORK STOCK EXCHANGE SHARE MARKET ACTIVITY
ACTUAL AND RELATIVE TO SHARE LISTINGS
Ratio Sales to Listings (Percent)
Shares Sold (Millions)
Shares Listed (Millions)
60
50
40
30
20
10
0
150
125
100
75
50
25
0
1500
1250
1000
750
500
250
0
MONTHLY AVERAGE OF TOTAL SHARES LISTED
REPORTED MONTHLY SHARE SALES
RATIO SHARES SOLD TO SHARES LISTED
1925
1926
1927
1928
1929

ever growing country possessed of such great natural resources as the United States. But the situation arising out of the high level of our security prices and the change in the rate of our industrial production did not make a panic inevitable. An orderly and gradual decline of prices such as took place during most of September and the early part of October would have brought about the necessary readjustment. If we are to look for the actual causes of the panic we must consider the other factors which combined to produce public hysteria and brought about the huge volume of liquidation with resulting conditions of panic.

Every serious break in the stock market is always attributed to over-speculation, but if we are to ascertain its exact responsibility for the 1929 stock panic, we must consider the actual facts. Many people seem to have the notion that the volume of trading on the Exchange is in itself a sign of unsound and harmful speculative conditions and a necessary precursor to stock panics. This view is, however, not at all supported by the facts. When one studies the volume of share trading on the Stock Exchange during recent years, it becomes at once apparent that the peak of activity occurred not before the crisis of October, 1929, but in November, 1928. This is all the more striking because of the fact that during 1929 there were added to the list over three hundred and fifty million additional shares of stock. Naturally the only accurate way to measure Stock Exchange activity is to consider the proportion of listed shares turned over. Figures in this regard show that through the first half of 1929 share dealings on the New York Stock Exchange were declining both actually and in proportion to share listings. If mere volume of dealings or proportionate velocity of dealings on the Exchange were a cause of the panic, we should have had a panic not last fall but a year ago.

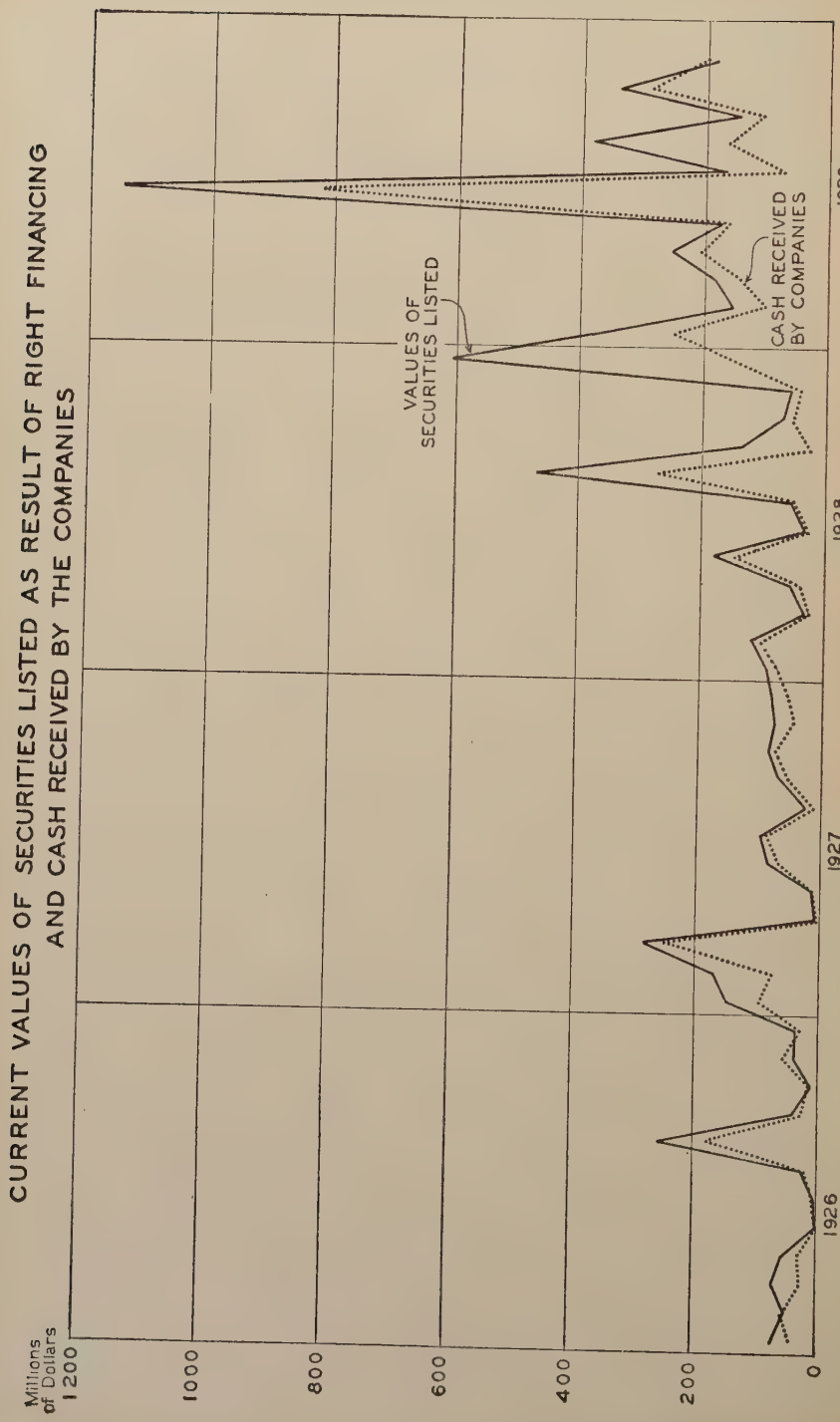
Actually it is not so much the volume of dealings in shares which indicates a dangerous stock market situation as the quality and the equilibrium of speculation in the stock market. For various reasons, some of which I will mention later, we have had in the stock market an extraordinary willingness to buy and an equally extraordinary unwillingness to sell. It was this lack of equilibrium which really made trouble.

It is now often said that the holding of securities on margin had become too great during last summer. The problem of regulating the extent to which the public shall employ credit to purchase or hold securities is one which cannot be solved by any single agency. The Stock Exchange by requiring large margins can and did exert a restraining influence but it could not control the situation because its rules and regulations apply only to its members. Many securities are listed on other stock exchanges besides the New York Stock Exchange, and many customers have banks carry their securities for them, even though the purchase of these securities was made for them by a stock broker.

Statistics taken off by the Stock Exchange from its members' questionnaires over the first six months of 1929 showed that the margins in customers' accounts averaged 40 per cent. of the market value of long stocks which they were carrying, and 65 per cent. on their debit balances with their brokers. I need scarcely point out how enormous these margins were. Never had margins in the New York brokerage business averaged anything like such high figures. These large customers' margins had been established through precautions taken for some time both by the New York banks and the New York Stock Exchange itself. The New York banks lending money on brokers' loans had for many months required ample margins on such loans, and had also frequently marked stocks taken as collateral at

prices far below existing market levels. The result was that during the first six months of 1929, Stock Exchange houses were putting up an average of 50 per cent. margin on the brokers' loans which they had contracted. The Exchange on its part examined with great care through its so-called "questionnaire system" the condition of its member firms, and insisted that the capital possessed by these firms must be maintained at a definite proportion to the commitments of the firm. It was due to these precautions by both New York banks and the New York Stock Exchange that the tremendous and hysterical wave of liquidation in the stock market during October and November did not lead to the failure of a single important New York bank or New York Stock Exchange house. Thus far, two New York Stock Exchange firms have been suspended for insolvency, but both of these firms were small, out-of-town houses, and there is, from what I can learn, excellent prospects that they will pay every single penny which they owe to their customers. I need not point out that this represents a magnificent showing both on the part of the New York banks and the New York Stock Exchange, when the severity of the break in stock prices is recalled. It is evident that the structure of finance, although naturally strained, stood the shock of the panic magnificently. I should perhaps mention too, that the enormous liquidation of brokers' loans from roughly 8½ billions to 4 billions in two months was not attended by a single loss to a lender. We had reason, however, to expect this result, because call loans have long been recognized as the safest and most liquid investment known to American banking.

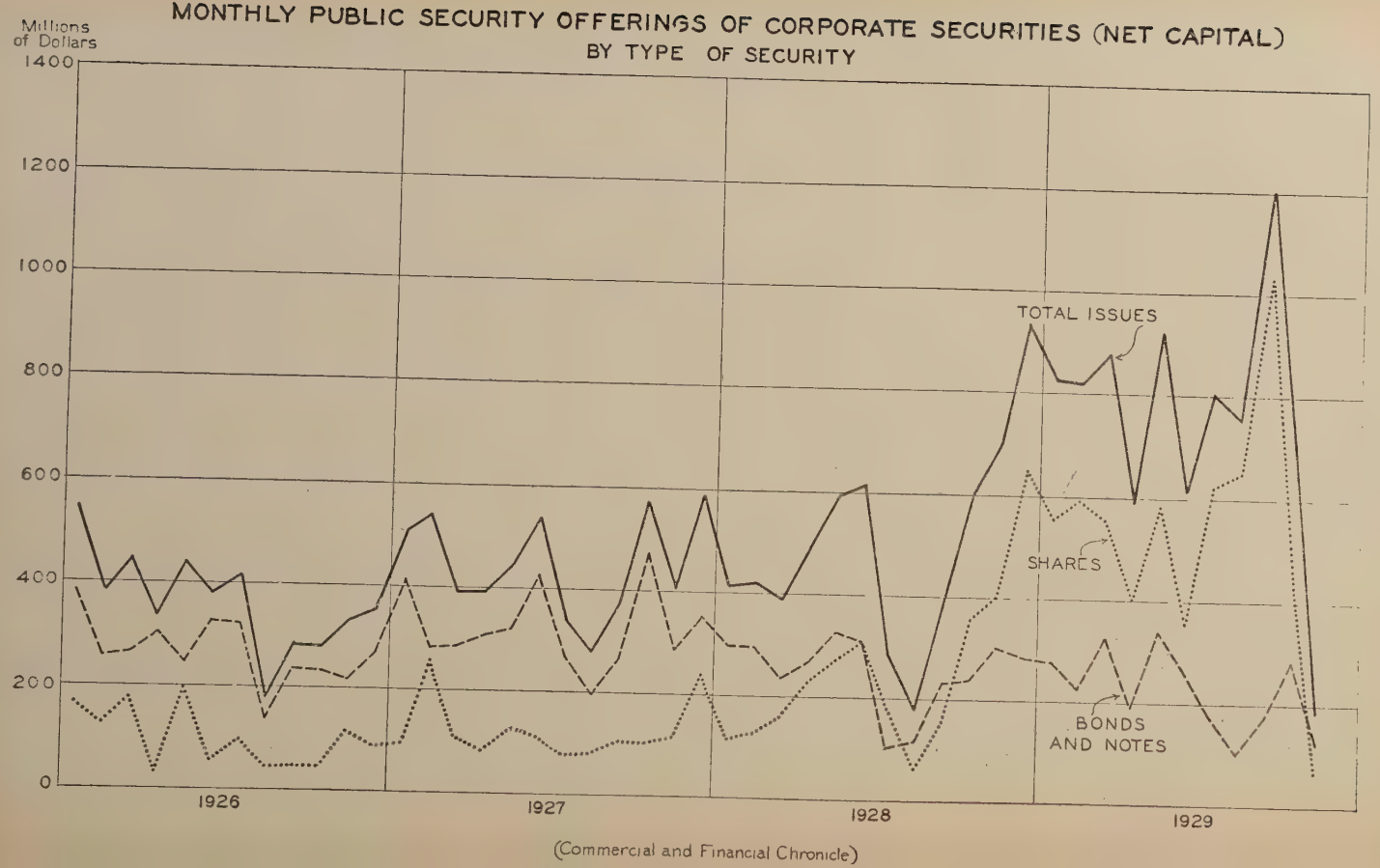
Nevertheless, under conditions of panic and public hysteria, even very large margins may not prove adequate to protect the holder of securities on credit, however much it may assure the safety of financial institutions. This fact has, I think,


CURRENT VALUES OF SECURITIES LISTED AS RESULT OF RIGHT FINANCING
AND CASH RECEIVED BY THE COMPANIES
Millions of Dollars
1200
1000
800
600
400
200
0
1926
1927
1928
1929
VALUES OF SECURITIES LISTED
CASH RECEIVED BY COMPANIES

surprised us all and must be remembered in the future.

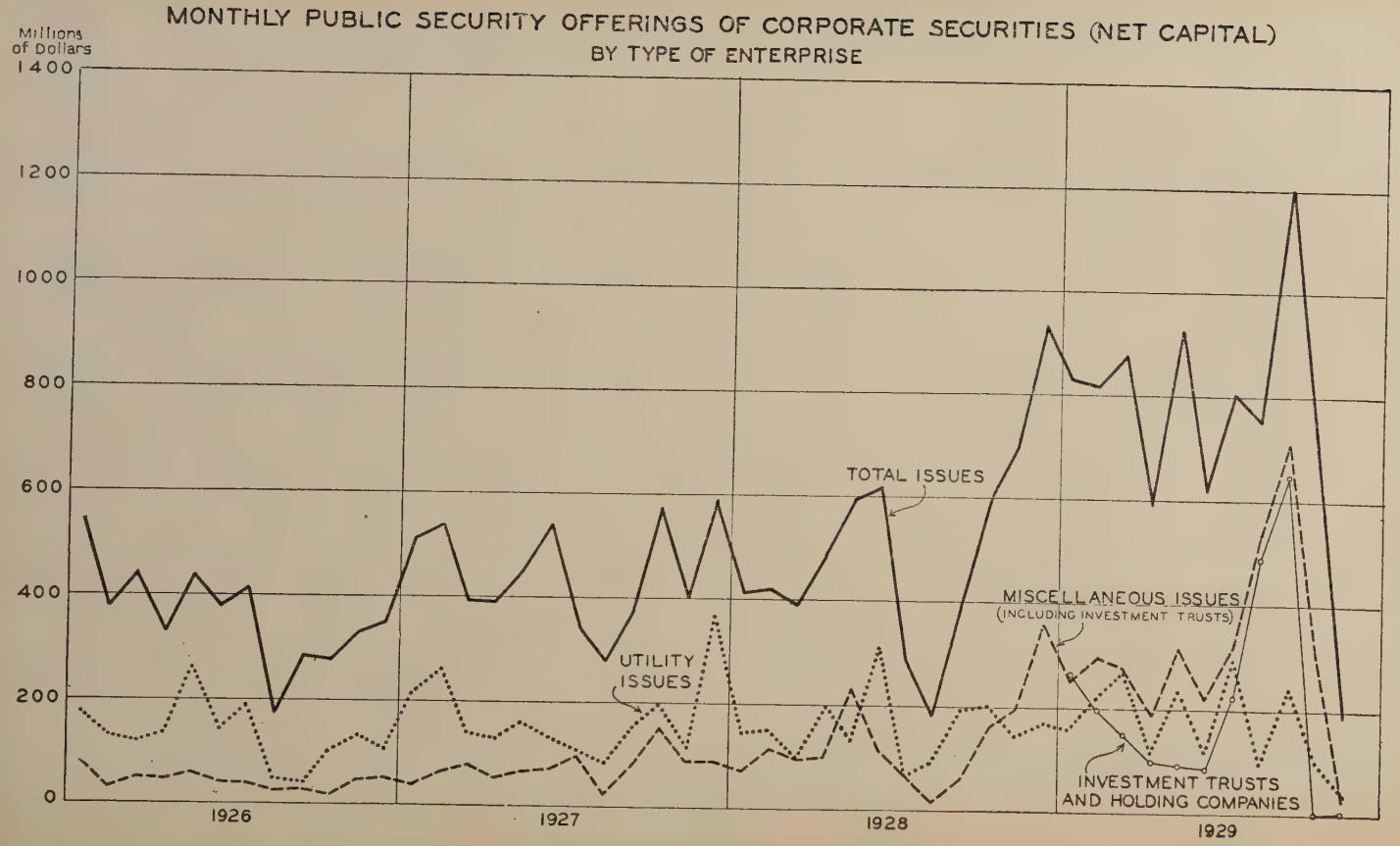
Ordinarily rising prices for stocks are checked by outright liquidation which over-burdens the floating supply and compels a recession. In the stock market of last summer, however, several different factors artificially delayed and restrained such liquidation—notably great public optimism and also the income taxes levied on capital gains. Thus, when liquidation occurred, it resulted in a much more violent price decline than is ordinarily the case. Many outright investors completely lost their heads and simply emptied their security boxes on the market, with harmful results not merely to themselves but also to everyone else.

In addition to the tremendous amount of domestic liquidation, the stock market also had to absorb considerable foreign liquidation, fostered by the events of the summer and early fall in Europe. These European developments were almost universally such as to cause nervousness and alarm among security holders on both sides of the Atlantic. In London, apart from the advances in the Bank of England rate, there occurred the extensive and very embarrassing Hatry scandal, the collapse of several other groups of speculative security issues, and the strain of continued gold exports. In Germany, conditions on the Berlin Stock Exchange became so critical as to require the intervention of the large banks to support the market. In Austria, the largest bank in Vienna had to be taken over amid very critical conditions by the Credit-Anstalt. In France, while constant gold imports were being sterilized and causing a critical scarcity in other markets, there was a serious cabinet crisis and for a time the disturbing prospect of a new ministry coming into office. All these European events conspired to put pressure upon the New York Stock Exchange which in recent years has more and more become an


MONTHLY PUBLIC SECURITY OFFERINGS OF CORPORATE SECURITIES (NET CAPITAL)
BY TYPE OF SECURITY
Millions of Dollars
1400
1200
1000
800
600
400
200
0
TOTAL ISSUES
SHARES
BONDS AND NOTES
1926
1927
1928
1929
(Commercial and Financial Chronicle)

international market. I feel that there is a serious lesson in this situation which we must learn. Many of those who have discussed the internationalization of the American security markets have presupposed that this trend necessarily made for greater market stability. In the long run, this is probably true. But, on particular occasions, the New York market must deal not only with pressure from within the United States, but also pressure from abroad. The same sort of thing has often happened before in London, when it was the leading international market of the world. We must consider European conditions more closely and more critically in the future as a regular factor in the New York securities market.

I now come to the factor which, at least in my own judgment, converted an inevitable but orderly declining securities market during September into the panic which we witnessed in October and November. I refer to the colossal output of new stock issues thrust on the market during September and October. The year 1929 had already proved to be a very active year in the production of new securities. In addition to a record amount of new stock issues publicly offered, the market was called upon to absorb an enormous amount of new stock issued by our leading companies through rights to subscribe. During the first ten months of 1929, companies listed on the New York Stock Exchange alone acquired the aggregate sum of $2,319,302,000 through right financing, which at the same time burdened the market with new securities to the extent of approximately $3,328,800,000. This right financing was particularly active in June last, when listed companies obtained $816,674,300 by the issuance of new securities which had a current market value of approximately $1,276,092,000. At the same time the public offerings of share issues, already very great, proceeded unabated; in July they amounted


MONTHLY PUBLIC SECURITY OFFERINGS OF CORPORATE SECURITIES (NET CAPITAL)
BY TYPE OF ENTERPRISE
Millions of Dollars
1400
1200
1000
800
600
400
200
0
TOTAL ISSUES
MISCELLANEOUS ISSUES
(INCLUDING INVESTMENT TRUSTS)
UTILITY ISSUES
INVESTMENT TRUSTS AND HOLDING COMPANIES
1926
1927
1928
1929
Commercial and Financial Chronicle

in net capital to about $800,000,000, in August to $750,000,000, in September to the prodigious sum of $1,200,000,000, and even in October to $725,000,000. In each of these months, the bulk of the securities offered to the public consisted of share issues, and largely represented the securities of new investment trusts and finance companies. In September alone, investment trusts and holding companies put on the market about $650,000,000 of new securities. In ordinary circumstances, such a huge issuance of new securities would at once have seemed excessive. But the idea seemed to prevail that investment trust and finance company issues did not actually absorb any new public capital, because the proceeds of these issues would be used to purchase other outstanding issues. Many of these trusts, however, loaned money on call and invested in foreign securities, instead of immediately buying American securities. The situation would have been vastly healthier if the public could have gained a more accurate idea of the actual assets behind American investment trust and finance company issues. The New York Stock Exchange had already formulated listing requirements for investment trust issues, calling for just such a disclosure of security portfolios, but few trusts listed their issues on the Stock Exchange, with the result that this effort for more widespread publicity as to investment trust assets and earnings proved of little avail. The investment trust has, of course, been a completely new feature in American finance, and its nature and functions have been very widely misunderstood and misinterpreted. Unfortunately, the results of American inexperience with investment trusts were visited last fall not merely upon investors in these trusts, but upon the whole American securities market.

III

There were also a number of factors which, while not basic causes of the panic, nevertheless aggravated the crisis and made it more serious than it otherwise would have proved. The first of these arose from income taxes on capital gains. Attention has frequently been called to the fact that the existing tax on capital gains has made holders of securities unwilling to sell because of the large percentage of their profits which they would thus be compelled to pay out for taxes. There is no doubt that this tax on capital gains greatly contributed to expanding the margin accounts of the public, to facilitating share price inflation, and to bringing about the very lack of equilibrium in the stock market that ultimately proved its undoing.

An additional source of aggravation arose from the mechanical inadequacy of the present stock ticker quotation system. The active markets of 1919 persuaded the New York Stock Exchange that better ticker facilities were necessary. The collection and dispatching of quotations from the floor of the Exchange were modernized some eight years ago. But further efficiency in the system could only be obtained by improving the ticker instruments which actually print the quotations all over the country. And this has been a vastly more difficult problem. By changing symbols for share issues, and abbreviating share quotations, the Stock Exchange did what it could to render the old ticker machine more efficient. These palliatives helped to some extent, but the extraordinary growth of the daily share markets in the last few years continued to require greater and greater capacity for speed and volume upon the tape, which could only be supplied by a ticker of novel design. Many suggestions and alleged remedies were proposed without practical results. Finally, a few years ago, a new

ticker machine based upon new mechanical principles was invented and successfully passed its initial laboratory tests. But these new stock tickers could not be used until the machine gave thoroughly satisfactory assurances not only of speed, but also of reliability against breakdown. Ironically enough, it was only a short time before the panic that the new machine proved itself sufficiently reliable to be installed. There is no doubt but what the delay experienced in obtaining quotations during the panic considerably aggravated the violence of liquidation. Not only did it lead to panicky selling, but in some cases stocks would have been better supported if their current prices could have been learned more promptly. The inadequacy of the ticker system was, I am persuaded, a cause of the tremendous volume of dealings and the great fluctuations on the worst days of the break. This whole situation with the ticker is all the more irritating to the Exchange because it occurred at a time when practical methods had finally been found for vastly improving the service in the course of another year.

Another cause in the minds of many people for the intensification of selling to the point of panic arose from "brokers' loans." This question of brokers' loans, particularly those made by "other lenders," has of course been a highly controversial subject for the past two years, and time does not permit my attempting any lengthy discussion of it here. Undoubtedly, the great increase in brokers' loans by "other lenders" during 1929 was due to the great demand for stock market credits necessitated both by rising security prices and by the huge amount of new share financing done for American companies, but it must be remembered that these loans represented in the main free capital which had been raised by corporations through security issues and which was loaned while it was awaiting investment. It is difficult always to say concerning past events

what might have happened under conjectural circumstances. But I am persuaded that a less artificially tight money market during the early months of 1929 and a more reasonable rate of interest on ordinary banking deposits would have prevented the undue extension of the loans for the account of "other lenders." In the last analysis, however, I do not believe that it was due to credit conditions that the stock market collapse occurred.

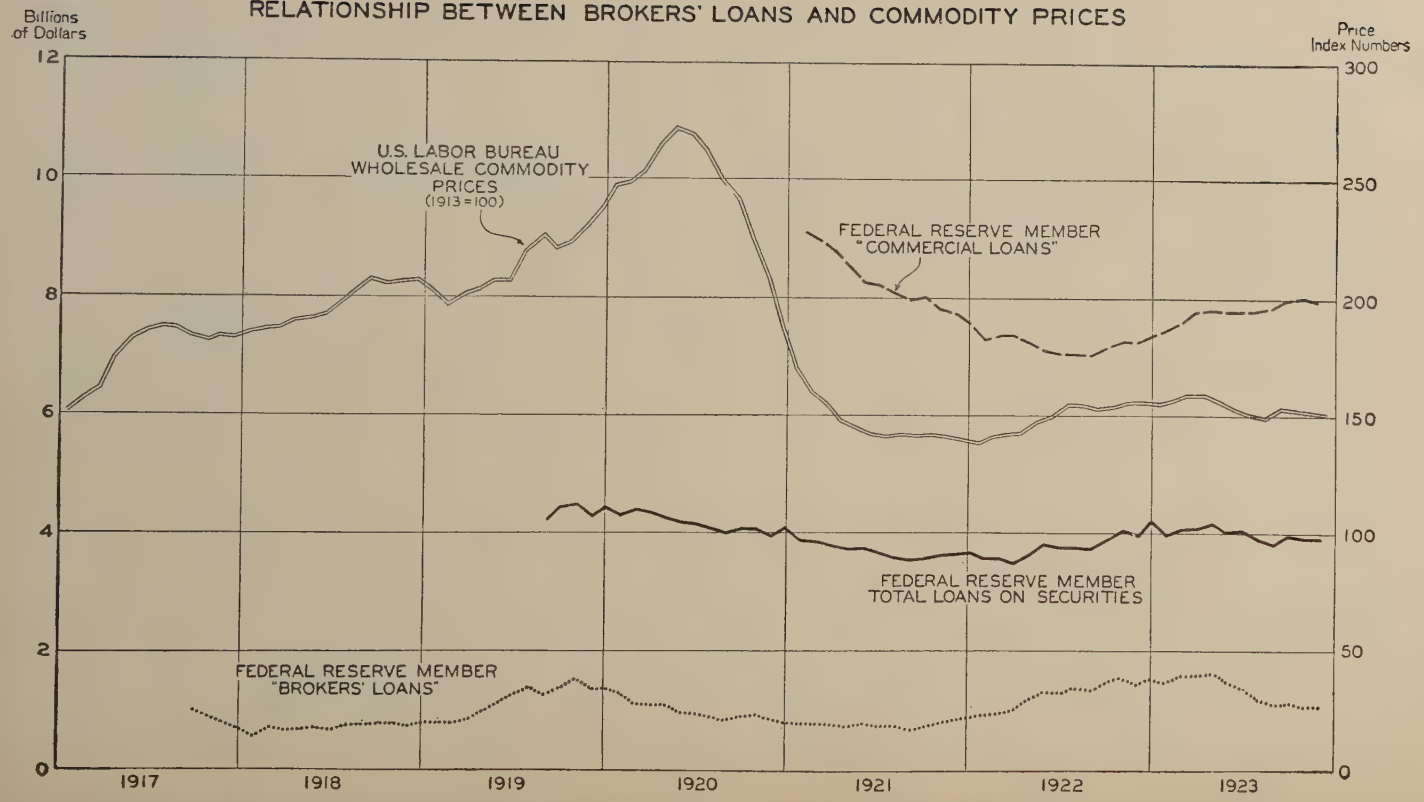
It is always of course very easy to criticise after the event. During the past two years, the Federal Reserve authorities have undoubtedly faced a very complex and in some ways a very novel situation. Any attempt to make the Federal Reserve system a scapegoat for the securities panic last fall would be both unjust and undesirable. It is, however, important that the moral of our recent financial difficulties should be clearly ascertained, if we are to avoid such episodes in the future.

After every stock panic people who have suffered losses, very humanly, hunt about for something or somebody upon which to lay the blame. At such times the short seller always comes in for sharp criticism because he is assumed to have made profits at a time when the vast majority of investors have suffered losses. Short selling is then constantly harped upon and greatly exaggerated and every price decline is promptly and positively attributed to bear raiding. The last panic was no exception to this rule. Entirely sincere and public spirited citizens have taken the New York Stock Exchange to task for not prohibiting short selling either temporarily or permanently.

It is, of course, difficult to determine the exact extent of the short interest at any given time, but fortunately, at one of the worst periods of the last crisis, the Stock Exchange by means of a special questionnaire sent to its members obtained statistics as to the current size of the short interest. The

amount of the total short interest at the close of one of the worst days of the panic was found to be extraordinarily small, constituting only about one-seventh of one per cent, of the total listed shares. This fact seems to me to be a conclusive answer to the oft repeated statement that in the latter days of the panic short sellers and bear raiding were responsible for the declining value of securities.

Many persons who criticize short selling consider only the depressing effect which the short seller is supposed to have upon the market; they ignore entirely the fact that a "short" as soon as he has sold becomes a compulsory buyer of stock at some time in the future. Since "shorts" must buy at some time they are in times of financial distress the backbone of the market. When prices decline sharply and most investors wait for the bottom of the market and most margin purchasers delay buying either because they are themselves embarrassed by the decline or because they are afraid that it may run further, it is the short sellers who become the buyers. Some economists believe that one of the reasons why the break last autumn proved so severe was the absence of a short interest adequate to absorb the great torrent of liquidation and they point out that during the last few years our great prosperity has made most people speculate for the advance and not for the decline. The steady and great increase in security prices during the last few years has resulted time and again in punishing severely the few traders who had the temerity to sell the market short and finally a point was reached last summer when the normal restraint imposed by short selling was practically non-existent and an undoubted inflation of security prices set in. The New York Stock Exchange, however, is not so much concerned in defending short selling *per se* as in promoting more orderly and stable markets. The experience of every leading Stock Exchange in the


RELATIONSHIP BETWEEN BROKERS' LOANS AND COMMODITY PRICES
Billions of Dollars
Price Index Numbers
12
10
8
6
4
2
0
300
250
200
150
100
50
0
U.S. LABOR BUREAU WHOLESALE COMMODITY PRICES (1913=100)
FEDERAL RESERVE MEMBER "COMMERCIAL LOANS"
FEDERAL RESERVE MEMBER TOTAL LOANS ON SECURITIES
FEDERAL RESERVE MEMBER "BROKERS' LOANS"
1917
1918
1919
1920
1921
1922
1923

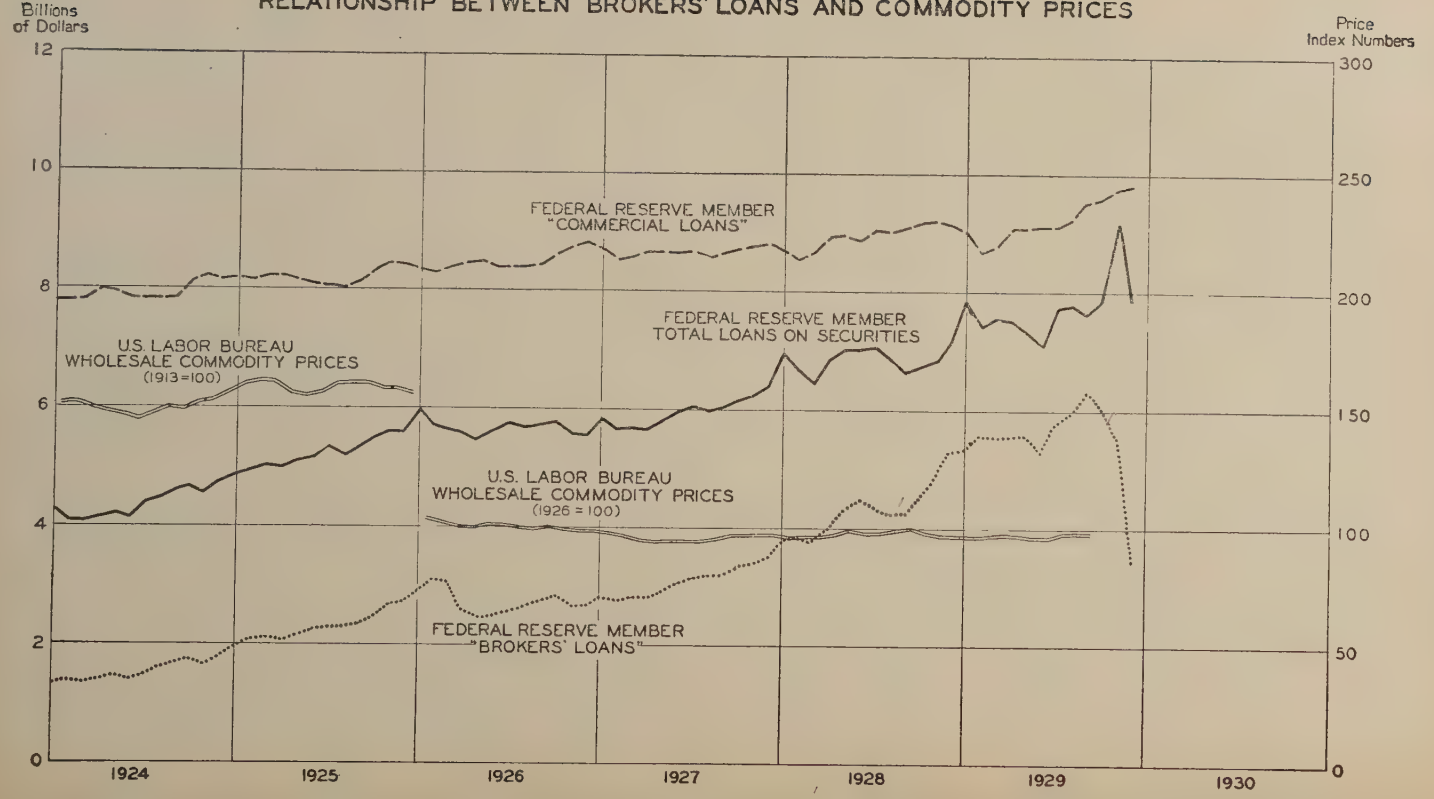
world proves that the short seller is indispensable to an orderly market and the Stock Exchange is therefore unwilling to forbid or artificially embarrass short selling. In taking this position the Exchange is relying not only on its own experience, which is of long duration, but also upon the fact that nearly every leading country in the world has at some time in the past actually experimented with laws forbidding short selling and in every single case, after the legislative experiment proved disastrous, the laws were hastily abolished.

IV

Recently the question on everyone's lips has naturally been what effect the liquidation of the stock market would have upon business. As I look at the matter, the stock market is very much more affected by business than business is by the stock market.

The stock market affects business mainly in three different ways: first, by pure psychology; second, by facilitating the flow of capital into corporate enterprise; and third, by the increased consumption which realized profits in the stock market make possible. The psychological effect of stock market activities on business is, I think, usually overemphasized and at most a temporary thing; if business itself is sound, the stock market cannot persuade the public otherwise. In fact, the stock market will at once tend to reflect improved business conditions by rising security prices. In regard to the second point, we must all realize that never before in our history has there occurred such a wholesale wave of corporate financing as during the past two years. My previous remarks respecting new public offerings of share issues, and also respecting financing through rights, have adequately illustrated this fact. Also the billions of dollars

RELATIONSHIP BETWEEN BROKERS' LOANS AND COMMODITY PRICES



invested by the public in American corporate securities recently have not to any great extent been invested in large high-priced inventories. In consequence, American companies today need less capital financing than probably at any time in our history and if the effect of the stock market crisis is to delay temporarily the issuance of new securities, I do not think this will be any real hindrance to business. The third point as to the effect of stock market profits on consumption is more problematical. Undoubtedly, the luxury trades have in recent years benefited from this source. Nevertheless, I think that most stock market profits remain in the market itself because of the reluctance of most stock speculators to set, in practice, any limit to the amount of money which they wish to make. In the main, therefore, I do not think that the fall in security prices will itself cause any great curtailment in consumption, and the trade figures thus far available seem to bear out this view of the matter.

Since the stock market liquidation, we have heard much about the prospective effect of returning to industry and commerce, funds previously tied up in speculation. I venture to criticize the careless acceptance of this view because its logical consequence may get us into a very much worse situation than the one which we are facing today. It is not at all apparent that either industry or trade in 1928 and 1929 were actually starved for funds. Not only is this the testimony of most commercial bankers throughout the country, but it is shown by the high levels throughout these years of the commercial loans of Federal Reserve member banks. But in addition to the short term funds provided by banking credits, there has been a vast permanent financing of American corporations of all kinds through the sale of stock—to our corporations the cheapest and most desirable character of financing ever seen in this country. Through the stock market, billions

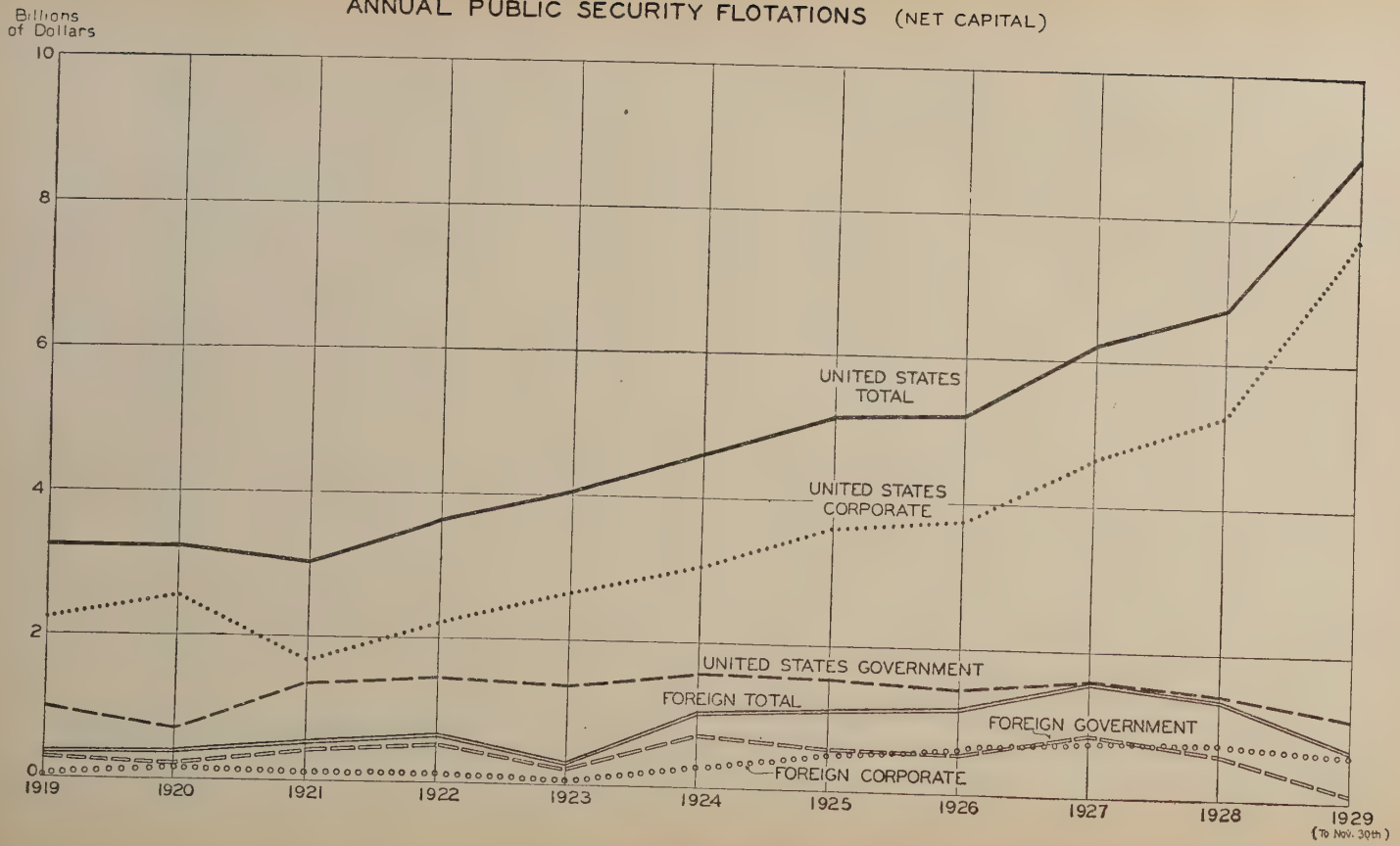
upon billions of capital savings have been rendered available for corporate purposes, and the present cash position of our companies generally does not support the contention that there has been a lack of funds for industry.

It is worth while contrasting this situation in some of its possibilities with the 1919-1923 business cycle. During those years, brokers' loans were deflated in the beginning of November 1919, and the resultant funds were loaned out to manufacturers, merchants and land speculators. There was the same talk at that time about releasing funds from the stock market for industry and trade. But the result was a huge upswing in commodity prices and a general commercial inflation whose crash in 1920 very seriously affected the whole country for a long period. During the past five years we have had no new commercial inflation and no new inflation of commodity prices. One reason for this situation has been the fact that surplus capital and credit could be steadily absorbed by the securities market. Security inflation is of course undesirable, but I think all economists would agree that the effects of security inflation are slight beside those of commercial inflation. If funds released by the liquidation of security loans are to be artificially thrust into commercial loans, I think we will have to watch very closely future movements in commodity prices and future tendencies toward commercial inflation. Actually the stock market together with stock market loans serve a very useful purpose in absorbing capital and credit which might otherwise facilitate, if not cause, inflation in the business field. Any attempt to stabilize artificially either the stock market or stock market loans may result in bringing on a worse evil than that with which we have already been struggling.

A final and still more profound problem raised by the recent security panic, consists in the proper

disposition of American surplus capital. For several years past, all signs have clearly shown that this surplus capital was very great, and that it was being absorbed by investment in securities. In the first few years after 1919, our surplus capital flowed largely into foreign loans because of the critical financial condition which even the best foreign borrowers were facing, and the high rates of return which such loans could therefore pay. In recent years, however, the trend in American security investment has been sharply away from foreign securities and toward American securities. By 1929, this tendency, as I have shown, resulted in a temporary over-financing of American industry on a long term basis. Some students of finance now hail the deflation of American security prices on the ground that our capital can now once more flow into foreign securities. Personally I do not believe quite so readily in the inevitable benefits of such a tendency. Foreign investments are valuable to any country if its funds can be put into first class loans, but there is no advantage in lending considerable sums abroad on poor risks. The strongest financial countries in Europe not only no longer wish to borrow from us, but are today competing with us in the foreign loan market, and even investing their money in American securities. This means that good foreign loans are difficult if not impossible to obtain.

Granted that our surplus of capital in this country is likely to be great in coming years— and I for one believe that it will be—we are liable alternately to face the necessity either of making dangerous loans abroad or raising the level of American security prices. I think our recent security price inflation has been due to just this situation, and unless new and safe fields for the investment of European as well as American capital are opened, I am not certain that future capital inflation both here and abroad


ANNUAL PUBLIC SECURITY FLOTATIONS (NET CAPITAL)
Billions of Dollars
10
8
6
4
2
0
1919
1920
1921
1922
1923
1924
1925
1926
1927
1928
1929
(To Nov. 30th)
UNITED STATES TOTAL
UNITED STATES CORPORATE
UNITED STATES GOVERNMENT
FOREIGN TOTAL
FOREIGN GOVERNMENT
FOREIGN CORPORATE
(Commercial and Financial Chronicle)

can be prevented either by private discrimination or public law. A thorough realization, however, of our position as a creditor country, should give us a more realistic view of these inevitable problems which our new financial status has created, and as our financial progress continues, should enable us to minimize both the alternate dangers of unwise foreign investment and domestic security inflation. Over-optimism may be dangerous but it is important to remember that the present problems of American finance rise, not from weakness, but from the profound strength of our country.

THE EVOLUTION OF STOCK EXCHANGES

At a Dinner of the Hartford Stock Exchange and the Connecticut Investment Bankers' Association, Hartford, Connecticut, February 28, 1930

THE EVOLUTION OF STOCK EXCHANGES

So many close business and personal ties have long existed between the financial communities of Hartford and New York that I must confess feeling very much at home with you here tonight. In financial matters I am sure we all speak the same language and are striving for the same ends. This is my excuse for attempting to analyze some of the basic problems involved in the development of stock exchange organization, and a consideration of the financial technique involved in this development.

II

In discussing the evolutionary process by which unorganized and more or less casual security markets have developed into definitely organized stock exchanges, I wish to take as my text two sentences from the Hughes Commission Report of 1909—still a standard document in many respects concerning the character and functions of American stock exchanges:

> "Markets have sprung into being wherever buying and selling have been conducted on a large scale. Taken in hand by regular organizations and controlled by rules, such markets become exchanges."

These two brief sentences give the best concise description of the evolution of exchanges with which I am familiar, and they apply not only to exchanges in the United States, but also to such of the European exchanges as at various times I have visited and studied.

At the outset, it is necessary to recognize that fundamentally it is buying and selling which create

markets. Moreover, the considerable volume of buying and selling which calls for the gradual development of organized markets cannot for the most part be artificially stimulated, but must in the long run arise naturally out of the economic environment and economic conditions in the territory which the given market serves. These economic factors which create markets are both numerous and complex. Among other things, they involve geographical circumstances, access to trade routes and communications, mercantile integrity and ability, and nearness to the centers of wealth and industrial production. It is the essentially economic character of these factors which create markets that explains why governments have never been able artificially to create markets—especially for securities. Such markets must, as I say, develop naturally as a result of economic evolution, and the most fruitful contribution to sound markets which governments can make is to allow them the greatest degree of private initiative and freedom of self-regulation. Throughout history, the broadest and best security markets have existed in those communities where freedom of trade and individual liberty were most commonly enjoyed. On the other hand, unwise governmental restrictions have many times in the past artificially halted market evolution and driven the business elsewhere. In the sixteenth century, Spain might have developed the greatest financial and mercantile markets in the world, had not the despotic and unreasonable policy of the Spanish Government paralyzed their growth and driven the business north to Flanders and Holland. In the United States we have thus far been fortunate in enjoying a governmental policy in regard to marketing and trade which has always been distinguished by the sound ideals of commercial freedom, and the vitality and high standards of American stock markets today are to no small degree due to this fact.

Markets must also continually face the serious

problem of economic competition. Even when fostered by wise governmental policies, markets have many times in the past shifted from one center to another because of changing trade routes or other inevitable economic factors. As the world's international financial centers have moved northward and westward since the fifteenth century, the process has left across Europe a wake of abandoned harbors, impoverished industries and weakened political states. Trade will always flow to the most favorable center, and the shifting of trade centers, although usually a gradual process, is a remorseless one which plays no favorites.

As a practical consideration, we must therefore recognize in the beginning that without activity a market cannot possess true significance. A stock exchange may construct the most magnificent marble building in the world, and it may have a disciplinary code of rules invented and enforced by supermen, but if active buying and selling orders do not come into the market, its importance immediately ceases.

III

A learned English authority, analyzing the history of financial London, has stated that the development of its financial markets has closely resembled the biological evolution of living organisms, in that both begin with a condition of simple structure and general functions, and end in a condition of complex structure and specialized functions. How accurate this generalization has been with regard to financial markets abroad I cannot pretend to say, but it does seem to characterize correctly the history of the New York Stock Exchange.

Prior to and during our Revolutionary War, there was no real security market in New York, or as far as I know elsewhere in this country, for the excellent reason that at that period practically no securities existed in which dealings could occur. The Revolutionary War, however, created a large national

debt, which Alexander Hamilton funded in the form of a government bond issue very large for those early times. Simultaneously, the new republic required banking and insurance facilities, and accumulated capital to found the earliest American banks and insurance companies by the public sale of stock. At once markets for these new forms of property developed, not only in New York, but also in the other older Eastern cities.

The earliest financial markets in New York sprang up in the midst of the existing commercial markets of the times. These consisted in the main of auctions often conducted on the river-front wharves. Thus, the first sales of securities in New York City occurred along with sales of imported European goods, American produce and even the now illegal commodities of African slaves and West Indian rum. The growth of security dealings, however, soon rendered it desirable to create specialized security markets. Accordingly, the earliest New York stock brokers and stock dealers became accustomed to meet under an old buttonwood tree that formerly stood in lower Wall Street, close by the wharves and coffee houses which in those days constituted the center of the city's commerce and trade. The records of this early period are naturally very scanty. But in the archives of the New York Stock Exchange there is still preserved the first stock brokers' agreement of 1792, drawn up by these early New York curb brokers. This agreement is the first sign of organization in the New York stock market. The agreement, however, merely provided for a fixed minimum brokerage commission and "preference to each other in our negotiations."

Two main problems faced this original stock market as it continued to conduct its business in the open street. The first of these problems consisted naturally in the need for proper indoor accommodations and facilities. The only mechanical facilities at that time available to the stock market consisted

in the buttonwood tree about which its members met. One skeptical American historian, however, perhaps indulging in the popular modern pastime of "debunking" history, has even asserted that nothing was left of the buttonwood tree at this time except its stump, as the British dragoons during the Revolutionary War had previously chopped it down for firewood. Whatever the truth of this matter may be, it is apparent that the facilities of this original curb market for stocks in New York were of the most primitive character. A second and more important problem which the early market faced, consisted in the necessity of regularizing its practices through better organization and discipline. But as long as the stock market remained in the public street, little could be accomplished in this direction. No real check could be placed on the character or numbers of the membership as long as any citizen had a perfect legal right to step up to the buttonwood tree and shout out bids and offers. For the same reason, no regulations could be enforced in regard to the character of securities bought and sold in the market, or indeed in regard to the specific methods of purchase and sale utilized by the members of the market. It was naturally impossible to fine, suspend or expel any broker or dealer in securities from a market conducted in a public street. I have no wish to make unflattering remarks in regard to the moral standards of these early brokers. They were, as a matter of fact, respected and substantial citizens. But it is apparent that they themselves were dissatisfied with the lack of discipline and regularity of their security market, for ultimately, as we shall see, they wholly revolutionized this situation.

The organization of the New York stock market could not occur, however, until sufficient business developed to justify it. This condition was reached in 1817 when for the first time the New York stock market moved indoors in very modest quarters in Wall Street. Naturally, in order to share in an

equitable manner the rent of these new quarters, it was necessary to organize a voluntary association of members headed by the conventional president, vice-president, secretary and treasurer. Chairs and a fire were also provided, and at length a clock, in order to regulate trading hours. From these simple beginnings developed the vast mechanical accessories of the stock market as we see them today. But still more important than the chairs or the clock was, after all, the matter of discipline and regularity in the market. This fact has been continually emphasized throughout the history of the New York Stock Exchange. The objects of the Exchange, according to its modern Constitution are "to furnish exchange rooms and other facilities for the convenient transaction of their business by its members; to maintain high standards of commercial honor and integrity among its members; and to promote and inculcate just and equitable principles of trade."

As I have stated, such ideals in regard to the character and methods of stock market business were at first impossible to enforce. But when the stock market moved indoors, this situation ceased to exist. The quarters of the market now possessed a door, as the Board soon came to realize. If a member engaged in improper conduct, he could now be denied entrance to the board room, either temporarily by suspending him from membership, or permanently by expulsion. In the shadow of these drastic means of punishment, fines for minor offenses could also be imposed. Thus there was provided the basis for discipline and rules which the Stock Exchange could itself formulate and enforce. To paraphrase the Hughes Report, the stock market had been taken in charge by a regular organization, was now controlled by its rules, and had now become an exchange.

IV

With the rules of the New York Stock Exchange today some of you gentlemen, representing as you do

New York Stock Exchange firms, are I trust already familiar. A century ago, however, the rules of the Exchange were both few and simple, and could be and were printed on only a few sheets of paper. The rules of the New York Stock Exchange at the present time constitute a good-sized volume, with a continual tendency to expand as the business of the Exchange grows greater and as new financial problems arise. In formulating these rules, it is often necessary for the Exchange to make tentative regulations which, if not later justified by experience, can be withdrawn or changed. The New York Stock Exchange, of course, cannot undertake to solve all the problems of finance, let alone even its own problems, before experience points the way. Also, the New York Stock Exchange has always to consider the fact that its member firms are doing business in competition with other financial houses not members of the Exchange and thus not bound by its restrictive regulations. If Stock Exchange regulations end by depriving the market of too much business, they will inevitably defeat any useful purpose which they might serve, because, as I have stated, a stock exchange which loses activity no longer possesses real significance. The Stock Exchange authorities, therefore, try to avoid burdening its members with complicated and severe restrictions. On the other hand, it is almost continually necessary to attempt to improve the character of the business by providing more adequate regulations, if the character of the New York Stock Exchange as the premier organized security market of this country is to be maintained.

The severity of Stock Exchange rules has often been commented upon. The Stock Exchange authorities continually go far beyond any existing requirements of public law in endeavoring to maintain what its Constitution calls "just and equitable principles of trade." Naturally, the Stock Exchange itself, and also Stock Exchange firms, are completely subject to the law of the land like everyone else. But

in addition, they must always consider these more far-reaching rules provided by the Stock Exchange Constitution. It speaks well, I feel, for the whole membership of the New York Stock Exchange that they should themselves year after year continually vote to uphold in this way a disciplinary code so much more searching than the public law. I have been President of the New York Stock Exchange for several years, and a member and a governor of the Exchange for many more. During these years it has been my experience that the Stock Exchange membership has continually thrown its influence in favor of stricter rather than laxer regulations, and higher rather than more casual standards of commercial integrity. The New York Stock Exchange is in fact a triumphant example of the possibilities of self-regulation in modern business, and it is often referred to as such by other less highly organized trade associations.

In the earliest years of Stock Exchange history, the administration of the Exchange was largely conducted by meetings of its entire membership. When this total membership was still relatively small and almost entirely confined in the location of its business offices to New York City alone, this simple method of organization proved reasonably satisfactory. It is also true that there were not in those early days the same complicated and highly technical questions requiring regulation by the Board. As time went on, however, the Stock Exchange membership grew, and the problems of the organization similarly developed an increasing complexity. Finally, in the decade following the Civil War, it became necessary to conduct the affairs of the Exchange through a committee rather than through meetings of the entire membership. As a result, the Governing Committee of the Exchange was organized as a body of forty, elected ten each year from the Stock Exchange membership. In the hands of the Governing Committee was vested practically all the basic power

of conducting the Stock Exchange affairs. Fundamentally this situation is clearly specified in the modern Constitution of the Exchange, and still characterizes its administration. The provisions attending the election of the Governing Committee afford sufficient flexibility to allow for desirable changes, and at the same time to give an also necessary consistency and continuity to Stock Exchange policy.

But our Governing Committee, like many public representative bodies, has had to adapt itself to a constantly increasing complexity of function, and steadily growing amount of detailed work. This has led to the practice of regularly appointing certain standing sub-committees of the Governing Committee to handle particular, important aspects of Stock Exchange administration. In addition, special sub-committees of the Governing Committee are from time to time appointed to make special investigations, and handle other matters of a generally non-recurrent character. Theoretically, the powers of these sub-committees were all in the beginning derived from the parent Governing Committee itself, and in many respects this is still clearly the case. On the other hand, there has been in the Stock Exchange Constitution an increasing tendency to give the standing committees of the Exchange more and more definitely recognized authority of their own, in order to increase the efficiency of their operations. I have observed that this same general system of government by committees characterizes not only the other American stock exchanges, but also most of the stock exchanges which I have seen abroad. Practically all stock exchanges, for example, are compelled to have some definite and reasonably small committee to handle the important work of admitting new security issues to dealings upon the exchange. The almost limitless detail involved in the proper discharge of this very vital Stock Exchange function would make it impossible for the

whole Governing Committee to be burdened directly with such work. The same thing might be said of many other important routine features of Stock Exchange administration.

Sometimes, in the cause of efficient management, it has been found advisable to organize certain operating departments of the Stock Exchange in the form of subsidiary stock corporations. Title to the physical properties and fixtures of the New York Stock Exchange is, for example, held by the New York Stock Exchange Building Company. The same thing is today true of our clearing and settling system. In the earliest days of security clearance in New York, the original New York Stock Exchange Clearing House was supervised by a sub-committee of the Governing Committee. This remained the case from 1892, when the New York Stock Exchange first organized its clearing system, down to 1920. But by the latter date, both the expanded volume of business handled and the widening scope of the clearing and settling system itself, made it desirable to incorporate this whole important adjunct of Stock Exchange operation into the present Stock Clearing Corporation. But the powers exercised by such subsidiary corporations of the Stock Exchange in each case are clearly derived from the Governing Committee itself. For this reason, Stock Exchange administration is actually much more centralized than at first instance it might appear.

In stock exchanges, no less than in representative democratic governments, it is necessary to provide for executive, legislative and also judicial powers. In the case of the Stock Exchange, executive direction is naturally placed in the hands of its President. But it is the Governing Committee which fundamentally combines both the legislative and judicial functions of the organization. In my previous remarks, I have spoken of Stock Exchange administration principally in its legislative aspects. But naturally the Stock Exchange must see to it that

the rules and regulations which it formulates shall be continually and fairly enforced. From this fact, the Stock Exchange organization in its judicial capacity has come to resemble a system of courts. Certain cases apparently involving a breach or infringement of Stock Exchange rules by its members are ordinarily taken in hand by our Business Conduct Committee or our Arbitration Committee. But often provision is also made whereby a member may appeal from the decisions of these important subcommittees, and have his case reviewed by the Governing Committee itself. For this reason, the Governing Committee in many respects retains a function in Stock Exchange affairs which resembles our American Supreme Court system. Over all these special arrangements for the conduct of Stock Exchange affairs, naturally stand the law courts of the nation.

It is certainly a tremendous advantage for the practical maintenance of justice to have decisions made by a body of men large enough and representative enough to be free from the element of personal bias, and trained by long experience in the sometimes highly technical subject matter under dispute. I have always felt that the trial of a Stock Exchange member before our full Governing Committee carried out in an almost ideal fashion the original conception of a trial of a defendant by a jury of his peers.

V

The formulation of Stock Exchange regulations necessarily has to avoid going to extremes in either direction. There is almost always one corps of critics which insistently demands that the New York Stock Exchange solve all the problems of finance, and cure all the actual or potential evils in the security business, simply by passing new regulations. On the other hand, complaint is sometimes made concerning the arbitrary character of the

regulations made and enforced by our Governing Committee. Steering a straight course between these two rocky shores is naturally a difficult matter. Yet in just this difficulty really consists the soundness and strength of Stock Exchange self-regulation. If the Stock Exchange attempted to engage in theoretical experiments or Utopian activities, or if it attempted to exercise its powers in an arbitrary and selfish way, neither Stock Exchange members nor the public would long tolerate it. It is because of this ever-present restraint on the regulatory actions of the Exchange, that so much success has actually been achieved in the work.

There is a final restraint upon the regulatory powers of the Stock Exchange which is also of tremendous consequence. I refer to public opinion itself. In the long run, the public will deal only in those markets in which it has a confidence based on facts and experience. As I have already emphasized, a stock exchange without activity is useless and meaningless, no matter what rules or facilities it may possess. The consideration which the security buying public of this country obtains at the hands of the Stock Exchange is, therefore, not simply a kindly or philanthropic gesture on the part of the Exchange, but a vital necessity to the Exchange's continued existence and success.

The layman who for the first time sees the floor of the New York Stock Exchange is, I think, more apt to be impressed by its telephones, stock posts, tickers and other mechanical appliances than he is with this invisible and intangible factor of regulation and discipline. Stock Exchange mechanical equipment is, of course, in itself a highly interesting subject, and sometimes provides very serious problems of its own. We have been finding this out recently in our attempts to provide a more adequate Stock Exchange ticker. But in the main these problems of mechanical equipment are in my judgment entirely secondary matters, and for the

most part can be left to the electrician, the carpenter and the plumber. What is infinitely more difficult is to provide and enforce fairly and justly a code of regulations adequate to maintain the free and open markets which is the economic function of stock exchanges, and the "just and equitable principles of trade" which must always be their moral responsibility to the investing public of the country.

ITALY AND AMERICA

Address before the General Bankers Confederation of Italy, Milan, Italy, April 9, 1930.

ITALY AND AMERICA

I very much appreciate the distinguished honor which you have done me by inviting me to address you here today. I have been, in fact, the recipient of so many courtesies, not only since I arrived in Italy, but even since I first stepped aboard the splendid Italian ocean liner "Conte Grande" in New York harbor, that it is very difficult for me to express my thanks.

This is my first visit to Italy, and unfortunately my stay here must be all too brief. Although I have visited several of the principal Italian cities, and through the kindness of many hosts have had the privilege of seeing something more of the life and spirit of your people than is ordinarily the good fortune of the American visiting this country, nevertheless I have naturally been able to obtain in this short time only a very superficial knowledge of your beautiful country and its modern-day problems.

But, after all, when that famous Italian, Christopher Columbus discovered the western hemisphere, and when his two compatriots—Caboto and Verrezano—first saw New York, those gentlemen undoubtedly knew very little about America, yet they did not hesitate to express all sorts of opinions concerning it. I feel it is high time for the American of today to return the compliment by discovering Italy, and you must therefore forgive me if, after this very short stay here, I venture similarly to speak of some of the impressions which I have gathered from it.

II

There is an old saying that "all roads lead to Rome." Certain it is that, in this modern world of ours, practically all elements of culture and civilization can be traced back to Italy. It was from this

historic soil that all the arts and many of the sciences first spread through Europe and throughout the world. Here the earliest conception of national government and law arose. Here Christianity also first began its ultimate conquest of Europe and the world. Even in my own profession of finance, it was the Italian city states which, centuries ago, first originated banks, discount markets and even dealings in securities. Upon the American, accustomed to the slight historical environment of so modern a country as ours, this profound background of Italian history and tradition necessarily makes a powerful impression. We come to realize how very sacred a trust modern Italy holds for all civilized peoples in the unequalled historical monuments and art treasures of your country. After visiting Pompeii and Rome, I am happy as a foreign visitor to testify to the admirable care and patient scholarship which the Italian Government is employing to preserve these priceless heritages of the past, which will always attract from other countries not merely the tourist motivated largely by mere curiosity, but also the serious student and the lover of beautiful things. Assuredly, they have also a proper setting in the great and varied natural beauties of the Italian peninsula.

So deep an impression is made upon the stranger by these unique Italian possessions, that it is perhaps not surprising that many foreign visitors here have gone away with the idea that Italy was a country whose spirit was more concerned with the past than with the present. This has been, of course, a great error. A very different aspect of modern Italy was revealed through the heroic efforts of the Italian people during the War, which were so deservedly crowned with the final triumph of Vittorio Veneto. Also, the subsequent suppression of communism—that evil disease from the Orient —created in all the modern countries where for a

brief time it struggled to obtain a foot-hold, a feeling of international solidarity, which was deepened by the subsequent stabilization of currencies and national finances which occurred in all the belligerent powers after the War. To a foreign visitor to Italy like myself, there is today at once apparent among your people a very pronounced attitude of national enthusiasm, of directed energy, and of economic accomplishment. I am after all not an art critic but a business man, and I must confess that the economic and commercial aspects of modern Italy appeal to my imagination fully as much as even the astonishing art treasures and ancient buildings with which your country abounds. This living Italy, which is and will continue to be a force in the modern world, is, however, much more difficult for the foreigner to understand than the Italy of the past.

The economic problems of Italy and of the United States are of course very different. The main problem of my country has been to populate the heart of a new continent and to exploit its great and largely untouched natural resources. The problem of Italy, on the other hand, is to restore to prosperity a country whose soil and resources are very old, and sometimes exhausted through natural infertility or former neglect. Obviously, the Italian problem is the more difficult of the two, and calls for a greater disciplined effort and ordered national energy. Yet it is a mistake to over-emphasize the importance of natural resources in such questions of national development. Russia, with probably the greatest natural resources in the world today, remains economically impotent and distressed, while Holland, with practically no natural European resources of importance, is a prosperous and highly cultivated country. In the rise or decline of states, much must always depend upon the national intelligence and the national will to achieve.

It is just this driving force of national spirit which one encounters in Italy. Even to the tourist, its practical results are apparent in your newly built railway lines and your magnificent motor roads. I have also read of the great efforts which modern Italy is making in draining and reclaiming marsh land in various parts of the country, and in reforestation. Even in as newly settled a country as the United States, our government also has for some years faced similar problems centering about the conservation of national resources, and for just this reason the vision and energy with which Italy has attacked her own problems of this sort are particularly interesting to us. What I have been able to learn of the great developments of hydro-electric power facilities here has also proved very interesting, for in the United States a similar movement has been strongly under way for some years. Unfortunately, most of the guidebooks for tourists in Italy, which tell us so much about your wonderful old palaces and historical monuments, do not inform us with equal care concerning these very significant economic accomplishments of recent years. I hope, however, that the admission to the New York Stock Exchange of Italian securities like Pirelli, Montecatini, Italian Edison, Fiat, Adriatica, Meridionale and others, will assist in giving our people a better balanced conception of modern Italy, particularly in respect to its vigorous economic development.

III

But the American does not need to cross the Atlantic in order to become very deeply interested in Italy and the Italians. So great has been the emigration of your people to the United States, that Italy is today the old homeland of a very important element in our own citizenship. For this reason, if we wish to study the European backgrounds of the

American people of 1930, it is no longer sufficient for us simply to visit England—we must make a trip to Italy as well. As I have travelled through Italy this spring, this thought has been constantly in my mind. I know my visit here will give me a deeper comprehension of my own country than I could possibly have had before.

It must not be forgotten that New York City is today one of the largest centers of Italian population in the world. If I am not mistaken, New York at present has slightly more inhabitants of Italian extraction than Torino, and is thus surpassed in this respect only by Naples, Rome and Milan. In many other American cities also, an extensive Italian influx has occurred. The Italian immigrant and his American-born descendents have already become a very important factor in practically all phases of American life.

The first Italians who came to America were as a rule poor men, and in the majority of cases they first engaged as unskilled laborers in construction work of all kinds. Many of the great building projects carried on in the United States—such as our railway lines, canals or dams and water-power enterprises—have been actually constructed by them. In addition, of course, some of the first-generation Italian immigrants became small shop keepers and also small farmers. Today, however, we are witnessing the development not only of these humble workers themselves, but also of their children, and their integration into the complex business life of our country. The Italian immigrants and their American-born children are, I can assure you, giving a splendid account of themselves. In 1917, they entered our army and endured the dangers and hardships of war with a courage and patience which the United States will not soon forget. They have consistently sought to obtain education, and to improve their economic position. Not only have they entered

the skilled trades in large numbers, but more and more they have been able to set up in business for themselves. The whole American people is becoming accustomed to eat Italian food, to hear Italian music, and to furnish its homes with furniture of Italian make or design. The new Italian-American is also making his mark in the professions, and succeeding in both medicine and the law. One of the greatest bankers in the United States has a name unmistakably Italian. It is of course natural that the Italian-American should distinguish himself in all forms of artistic accomplishment, whether in music, or the decorative arts, or in architecture. Since I have been in Italy, I have sometimes wondered just how much the design of many of our skyscrapers really owes to memories of the Italian campanile. However, every country in the world has for a long time directly imitated Italian architectural design. When in Florence recently, I had the opportunity of seeing the splendid old palace which provided the model for our present New York Federal Reserve Bank building.

It is my own belief that this large Italian-born or Italian-descended element in the United States is destined to make a profound and most valuable contribution to American life. The future culture of America will undoubtedly owe much to the inherent Italian love of life, and imaginative sensitiveness to beauty. All nations have copied and imitated Italian art, but America has done even more for her future cultural life by tempering the more stolid northern racial strains with the very blood of the Italian race. However great the loss of these sons and daughters of Italy may prove to the mother country, you can at least feel no small gratification that across the great waters the vital Italian genius and spirit is today playing a creative part in the rise of a new and not insignificant national culture.

IV

My only purpose in making this address is, as far as I may, to further a more complete understanding between our two countries, and to strengthen the many existing ties of mutual sympathy and admiration. I think you all appreciate that my remarks should be taken entirely as the opinions of a private American business man who, through contact with American stock exchange problems, has every reason to seek a better understanding and friendship between business interests in his own and other countries.

But this quest in itself is no easy undertaking. It is always so difficult to understand other peoples, and so fatally easy to misunderstand and misinterpret them. This is no less true in the economic and business field, than it is in the relations of governments. So many people in every country are inclined to think that their own ideas and methods should be completely adopted by all other nations too. This is of course a very great fallacy. Actually, every race and nation has its own particular gifts and abilities, and the civilization of the world is often better served by the differences than by the similarities between them. Thus it is apt to be a great mistake for any country with strongly marked characteristics, to attempt too much to resemble some other country. I have often had this feeling in many different countries in Europe, when discussing American methods. Sometimes people in Europe have, for example, expressed great interest in our so-called "quantity production" machine methods, and have declared that European industry should be revolutionized so that it could operate in exactly the same way. About this I am by no means certain that they are right.

Undoubtedly our mass production methods in the United States have been very useful and beneficial

to us in many ways. But such methods are very well suited to a country like mine, which has abundant raw materials, a great domestic market for merchandise, and a marked similarity of tastes throughout the country. In other nations lacking these particular characteristics, such a system of production would not of course be equally easy to establish. It is also true that our machine production tends to eliminate individual craftsmanship. America, as a relatively young country, can better afford to sustain this loss, than could a country where craftsmanship has been developed to a very high degree through the continuous experience and skill of generations. In large measure, such undoubtedly is the situation with Italy, so many of whose products owe a great deal to the lively intelligence, high artistic standards, and conscientious skill of the traditional craftsman. It would be a real loss to the world, should Italy endeavor, by inaugurating machine production throughout her industries, to do away with her Venetian glass or lace, or with her extraordinarily fine leather, stone or wood work. On the other hand, I am not so sure that if more vigorous salesmanship were employed, Italy could not find a much wider market in the United States for many of the highly artistic products of her old hand industries. But in any case, it seems clear that Italy and the United States have still much of value to learn from each other in trade and industry, and there are a great many products typical of the genius of each country which can be very beneficially exchanged in trade.

As in commerce, so also in finance, a very wholesome and beneficial relationship, I feel, already exists between our countries. The very considerable sums of American capital which have been invested here, show the confidence felt by American bankers and investors in both the present

and future stability and progressiveness of Italian industrial enterprise. I may add that the securities representing some of the leading Italian industrial companies have been listed on the New York Stock Exchange, and that this development has naturally created an important link between the two capital markets of Milan and New York. It should of course be recognized that the United States itself requires large amounts of capital each year for its own continued economic development. This is, perhaps, not equally true of other centers for foreign investment, and it sometimes causes the American market to be considered as over-particular. It is also true that, over the past hundred years, the New York securities market has developed a quite strict and complicated technique for handling American securities. As a result, when our market is called upon to handle foreign securities, we must naturally be at least as strict with them as with our own issues. This fact is not always appreciated abroad. Sometimes, for example, people in Europe think the American demand for all kinds of company statistics is unreasonable and excessive, until they realize that this is something which we regularly require of our own companies.

The necessity for extensive technical regulations has been forced upon the New York Stock Exchange, particularly in recent years, by the rapidly expanding scope and volume of its work. During the year 1929, 4,200,000 shares of stock were sold on its floor during the average full trading day, and over the whole year the activity of the market amounted to 871,000 shares of stock each hour, and 14,500 shares each average minute. At the beginning of this year, the market value of all securities listed on the New York Stock Exchange amounted to over $100,000,000,000 and share issues alone to over $64,000,000,000. Without many de-

tailed regulations, this very heavy volume of Stock Exchange activity could not of course be handled in an orderly and systematic manner. But as our future financial relationship develops, these and other similar matters will, I am certain, come to be better understood both in Europe and in America.

V

I cannot conclude my remarks without mentioning one quality of modern Italy which is particularly striking to the American. I refer to the enthusiasm of the Italian people for the future of their country—an enthusiasm which is youthful and obviously a source of national energy. In this respect, Italy is much like the United States. We Americans are often accused of being over-enthusiastic and over-optimistic. This was especially the case, I am afraid, after the sharp decline of our stock market last autumn. Yet it is for this reason that the eternal youthfulness of the Italian people is so attractive a quality to Americans, and one with which I think we have a particular sympathy and understanding. After all, confidence and faith are a very necessary thing in modern life, and little indeed can be accomplished without them. We may need an intelligent skepticism to direct our energies, but without enthusiasm we would have no energies to direct.

I cannot claim to be a great student of history. But I cannot depart from this most hospitable and interesting country without wondering just what results this renewed faith of yours in your future national development, this disciplined yet at the same time vital energy with which modern Italy is attacking her fundamental economic problems, may hold in store, not only for Italy herself, but for the world. The day was, long ago, when this same Italian race created under the old Roman state a strength of individual character, a grandeur and

solidity of institutions, which for many centuries inspired as well as ruled the world. A second time, centuries afterward, the Italian cities of the Renaissance, by creating a new conception of human life and human activity, again transformed the culture of the world. Can it be that once again this Italian people, that is so old and yet so eternally young, is now embarking with unspent energies upon a course of national reorganization and betterment whose future consequences to the world may be similarly significant?

Despite difficult problems and serious obstacles, it is my own belief that through this conscious effort and this directed energy of the present time, Italy is fated to achieve a future destiny in all ways worthy of her past high traditions in culture, civilization, and influence in world affairs.

SOME ASPECTS OF MODERN AMERICAN FINANCE

Address before the Zurich Stock Exchange Association, at Zurich, Switzerland, April 11, 1930

SOME ASPECTS OF MODERN AMERICAN FINANCE

I appreciate very deeply the courtesy of your invitation to be with you here today, and to make a few remarks upon financial topics of mutual interest to us. I must confess at the outset that since my arrival in Switzerland, I have been astonished at the wide knowledge of American industry and finance possessed by some of your business leaders. It has persuaded me that it will not be out of keeping for me to refer in a more detailed manner than I had first intended, to certain present-day aspects of the American financial situation, particularly in their relation to international investment.

II

Ever since the war, the United States has been a leading creditor nation, and has regularly each year invested considerable sums in foreign securities. But in any given year, the extent of such American investments abroad has depended not only upon the need or desire for capital in other countries, but also upon the demand for investment funds within the United States themselves. Unlike many of the older creditor nations of Europe, America is still in the economic sense a young and only partially developed country. Its own unexploited resources still not only make possible but regularly demand the continued investment of vast amounts of the savings of our people, and very naturally American business enterprises have a first call upon American capital. As long as this condition remains, the amount of capital which America can spare to invest outside of its own borders is likely to vary considerably from year to year. Thus far at least, American

foreign investments have been made more to dispose of an otherwise embarrassing surplus of capital, than for any other reason. The events of the past year, at least in my own opinion, have shown that too rapid a flow of fresh capital into our own enterprises leads to inflation. Nevertheless, it is probable that foreign demands for our capital in New York must always compete with a sound and very extensive American demand.

Both for this reason and also because of the fact that many American investors are still inexperienced, the New York Stock Exchange has been led to formulate what are sometimes considered quite rigorous requirements for the admission of securities to dealings upon its floor. I have sometimes heard European bankers express astonishment at the amount of information concerning company assets or earnings called for by our listing requirements. It seems only fair to point out that in following this procedure, the New York Stock Exchange is doing with foreign securities only what it has for many years done with even the best American security issues. Naturally, the Exchange could not open its facilities more readily to foreign issues than to those which represent American industries. One primary reason why the listing requirements of the New York Stock Exchange are more severe than is usually the case on the large stock exchanges in Europe, arises from the fact that, unlike most European nations, the United States has no national law for incorporating new business companies. In contrast, for example, to such a statute as the British Companies Act in Great Britain, every one of the forty-eight states of our Union can and does issue charters to new incorporated companies, under widely varying degrees of carefulness or carelessness. The result has been that the New York Stock Exchange, as the leading capital market of the United States, has been unable to pass responsibility for its

listed issues to a national law, but instead has had to establish standards of its own in this respect.

It should also be realized that the New York Stock Exchange, when it requires from an applicant for listing detailed statistics and other information, is not seeking this information for itself but for the entire investing public. Indeed, our requirement is not that the company applying for a listing shall furnish the Exchange with confidential information, but it shall make such information public by furnishing it regularly to the press or to the stockholders. Such a policy of publicity is in America even more desirable today than previously, because of the inexperience of many of our investors. The New York Stock Exchange cannot of course undertake to advise the public as to what particular security issues should be purchased, but we feel that the Exchange can and should do all that it is able to make available to the public adequate information upon which each investor may base a reasoned and intelligent judgment for himself.

III

But the historic role of the United States has been to furnish investments rather than capital to Europe, and despite the recent tendency of our savings to flow abroad, foreign investments in American securities are still of course extensive. Undoubtedly, this is the aspect of America most interesting to a creditor country like Switzerland.

Few financial observers seem to feel any serious doubts concerning the future growth and prosperity of the United States. But while this apparently bright outlook ahead of American business enterprise is of course a factor of great importance to the soundness and attractiveness of American securities—and particularly of our common stocks—it must still be admitted that a judicious selection among different American issues is thoroughly

necessary. Furthermore, as the sharp decline in the stock market last autumn evidenced, it is always necessary when purchasing American stocks, carefully to consider the existing price-level. One can still suffer severe losses, not only through purchasing inferior issues, but also through purchasing even the best American issues at exaggerated prices.

Unfortunately it is easier to counsel caution in such matters with vague generalities, than it is to determine at any given time whether share prices are or are not too high. There is in fact, no infallible formula to determine precisely what prices share issues should sell at, and any intelligent judgment on this subject demands consideration of a wide variety of different factors.

Some security purchasers have in the past judged stock prices almost entirely according to whether they had recently risen or recently fallen. In fact, many statistical charts have been developed by students, which purport to show levels at which stocks should be purchased and sold. Such simple formulas as these cannot, however, be altogether depended upon. In the first place, they are largely based upon so called "stock price averages" or "stock price indices" which have often proved themselves unreliable as far as the entire stock market is concerned. Furthermore, they are based wholly upon past conditions, and thus fail to give adequate consideration to changing economic and financial conditions. Finally, the duration of upward or downward movements in share prices is largely if not wholly unpredictable, as was seen when our share prices advanced for five straight years, from 1924 to 1929.

Another important yet not all-sufficient test of stock price levels consists in the relative size of dividends which are being paid. Theoretically, of course, one should expect to find a certain correspondence between the yield of shares and current

money rates. Practically, however, share prices are by no means as sensitive in America to changes in money rates, as are bond prices. The consideration of dividends is also complicated by the frequent habit of American companies to pay their dividends in stock rather than in money, and also to issue to shareholders rights to subscribe to additional stock. In actual fact, therefore, it is much more difficult to determine the actual percentage yield of an American stock, than might at first appear.

Perhaps the soundest and most reliable test for stock prices consists in the present or prospective net earnings of the given company. For dividends may or may not be paid, according to the policy of the company directors. Yet a stock which consistently reveals good earnings should ultimately reward its owner well, irrespective of the dividend policy of the company in the meantime. Nevertheless, even this element of earnings provides no adequate formula by which to test existing share prices, or to reveal an inflated price structure. For in most cases the statistics relating to American company earnings relate to the past rather than to the present. An even greater difficulty of course arises from the variety of bookkeeping and accounting methods which companies employ in compiling their earnings statements. We can all, I am sure, recall companies in either Europe or America, which consistently conceal earnings by charging unusual amounts to depreciation and by other similar bookkeeping methods. In consequence, it is all very well to advise the investor to study carefully the relationship of share prices and share earnings, but to ensure accurate judgment something must also be known concerning how earning figures are actually derived.

A final factor of importance in judging American share prices consists in the existing relationship between the funds available for investment and the

securities available for purchase. This consideration is often overlooked because no adequate statistics can as a rule be obtained in regard to it, yet experience shows it to be highly significant. Inevitably, when more capital seeks investment in New York than there are adequate securities to take it up, security prices will tend to rise. Similarly, when securities available for sale overbalance the amount of capital seeking investment, security prices are practically bound to decline.

I should not have dwelt upon these perhaps elementary considerations respecting stock price levels, if it were not for the fact that confusion in regard to them was largely responsible for the drastic fall in share prices on the Stock Exchange last autumn. It is of course, so very easy to generalize concerning share price levels, and so very difficult to apply such generalizations to particular situations. The character of the United States as a country of continual growth and rapid change causes additional complications to accurate judgment in those problems of security price levels which, even in the oldest and most slowly changing countries, still present formidable obstacles to adequate analysis.

IV

It is highly important when considering either the recent past or the probable future in the American securities market, to bear in mind the extraordinary changes which of late have been going on in the structure of American business institutions themselves. While the ultimate results of many of these structural and functional changes in our business methods are of course unpredictable, they have nevertheless advanced sufficiently far to make us wary of accepting longer at face value many of our former ideas and axioms concerning the course of our business affairs.

The last ten years have witnessed a great shrinkage in the mercantile jobbing business, and products have tended to flow more swiftly than ever from manufacturer to retailer. But the commercial retailer has also suffered severely from the competition of chain-store organizations. Thus all our merchants have avoided as far as possible keeping large inventories of goods available for sale, with the result that often the manufacturer has been forced to assume the function of keeping the immediate market supplied. But the costly lesson of 1920, when our manufacturers had large inventories, has developed a new manufacturing technique whereby the rate of production is adjusted closely to the existing commercial demand.

The American manufacturer has also been forced to consider very carefully new inventions and the sudden rise of competing products. Industrial research has made enormous strides in the United States in the past few years, and today is a consistent factor in stimulating not only improvement, but also almost continual change in our manufacturing processes. The abundance of American capital has also facilitated great company mergers, not only in the industrial but also in the commercial field.

Naturally, these radical and far-reaching changes in American industry and commerce have caused almost equally great changes in American finance. Our commercial banks have frequently found that corporate clients who formerly borrowed funds at their counters, are now obtaining permanent capital either by accumulating large reserves from earnings, or else by selling their securities in the stock market. On the other hand, the great savings of the American people have led to huge savings deposits in our commercial banks, which have thus become distributors and investors of capital as well as creators and issuers of bank credit. This transformation has in turn led to a strong movement toward branch

and chain-banking, the outcome of which cannot at present be foreseen.

Investment bankers have also experienced the onset of many unaccustomed economic forces. In America the investment banking business was originally based upon the issuance and distribution of bonds. But in the last few years, our leading companies have shown a marked preference for stock issues as a method of obtaining new capital, and likewise the American investing public has clearly exhibited an extraordinary willingness to buy shares, and an equally marked unwillingness to buy bonds. This shift has very largely transformed the methods of American security investment firms.

In addition, we have been witnessing the rise in America of an almost new type of financial institution—the investment trust. In the last few years, billions of dollars of American capital have been placed at the disposal of these trusts, and they have become an undoubtedly permanent, but still largely unpredictable, factor in the New York stock market and in the distributory processes experienced by American security issues.

A final effect of this huge wave of financial and economic changes recently wrought in American business, has been a great expansion and an increased activity upon our stock exchanges. While the high records for this activity on the New York Stock Exchange last year may not be equalled for some time to come, nevertheless there is no doubt that a permanent expansion has occurred in the Stock Exchange business. In the five years of 1925-1929, for example, the number of shares listed on the New York Stock Exchange has expanded from 433,000,000 shares to over 1,100,000,000 shares—thus not quite tripling during this period. At the first of this year, total securities listed on our exchange possessed an aggregate market value of over $100,000,000,000, of which share issues contributed roughly $64,000,000,000.

V

Americans are often accused of being incurable optimists, but I think it must be confessed that the vast development which the United States has experienced in the past has, even despite temporary halts and interruptions in our growth and prosperity, amply justified our consistently confident frame of mind. I must also confess that whenever I am abroad, I find so many leading European financiers and economic students who seem equally optimistic concerning American business development and the substantial values of American securities, that I am all the less inclined than I might otherwise be to apologize for my own optimism. I do not happen to believe that wisdom in financial and business affairs is the exclusive possession of my own countrymen. Yet, even though we as individuals may at times blunder and fail of adequate vision in the conduct of our commercial and financial problems, the vast and silent growth of the North American continent soon obliterates our shortcomings and urges the country onward to new peaks of national achievement. Americans are thus very fortunate in being able, irrespective of national vanity, still to have every confidence in the future of American business, and the securities which represent it.

I would scarcely have permitted myself to utter sentiments which might otherwise be interpreted as mere complacency, did I not realize how extensive is the knowledge of American affairs possessed by the Swiss, and how constant has been the flow of Swiss capital into American securities. For the bankers and investors of Switzerland have with their proverbial sagacity participated to a greater extent than is commonly realized in the financing of American industry. Indeed, certain financial firms of Swiss origin have notably assisted in furthering the economic development of the United States and

have attained an enviable standing in our country for probity, progressiveness and soundness.

This financial relationship productive in the past of so much mutual advantage has only strengthened that bond between our two countries created by those of your people who have emigrated to our shores. Many, indeed, are the prominent Americans who trace their ancestry back to the cities and villages of Switzerland. Indeed, not merely America, but the whole world must recognize the continual contributions to human betterment which Switzerland has made. As the oldest existing democracy your land can fairly claim to have pointed the way toward political and individual liberty. Here too, impregnably secured by your tremendous mountain barriers, has always existed a haven of peace and international understanding. It is well that strangers from afar should come here freely to acknowledge our indebtedness to the high spirited peoples who have so long maintained liberty and freedom among the lofty slopes and valleys of this beautiful country.

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